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No. .....

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1980

SOL NEIL CORBIN, as Trustee in Bankruptcy of Franklin New York Corporation,

Petitioner,

and

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, et al.,

Respondents,

—against—

FEDERAL RESERVE BANK OF NEW YORK, FEDERAL DEPOSIT INSURANCE CORPORATION, in its Corporate Capacity and as Receiver of FRANKLIN NATIONAL BANK,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Questions Presented

I. Does the Vanston/Fleming doctrine of this Court* bar inequitable post-insolvency interest claims in the federal receivership liquidation of an insolvent national bank under the National Bank Act?

II. Does the Vanston/Fleming doctrine bar the Federal Reserve, as a secured creditor, from consuming the assets of an insolvent national bank by a claim for $60.7 million of additional post-insolvency interest, which amount is far greater than the Federal Reserve would have earned on its own funds if it had been paid earlier?

III. Does the Vanston/Fleming doctrine bar the Federal Reserve, as a secured creditor of an insolvent national bank, from receiving $30.2 million of interest upon post-insolvency interest from the assets of the insolvent bank?

IV. Does the Vanston/Fleming doctrine, or an equivalent equitable doctrine applicable to insolvent national banks, bar any part of the $294.6 million of post-insolvency interest being claimed by the Federal Reserve as a secured creditor in the instant case?

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* For a description of the Vanston/Fleming doctrine, *see* pp. 9-13 *infra*.

Parties

Petitioner is the Trustee in Bankruptcy of Franklin New York Corporation, which is both the parent corporation and an unsecured creditor of Franklin National Bank. Petitioner has no other subsidiary, parent or affiliates, except for wholly-owned subsidiaries. Some 1,000 public noteholders are creditors of Franklin New York Corporation and, with its stockholders, are the persons affected by this petition.

In addition to the parties named in the caption of the case, the following are additional plaintiff-intervenors to the proceeding in the Court of Appeals: Berkshire Life Insurance Company, Connecticut Mutual Life Insurance Company, The Minnesota Mutual Life Insurance Company, Morgan Guaranty Trust Co., as Trustee, New England Mutual Life Insurance Company, Occidental Life Insurance Company of California, The Penn Mutual Life Insurance Company, San Francisco City and County Employees' Retirement System, Shell Pension Trust, Southland Life Insurance Company, State of Wisconsin Investment Board, United California Bank, as Trustee, United States Trust Company of New York, as Trustee, and Western Life Insurance Company.

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Opinions Below

The opinion of the Court of Appeals for the Second Circuit (A 1a)* is reported at 629 F.2d 233. The petition for rehearing was denied by the Court of Appeals on September 9, 1980 without opinion. The opinions of the District Court for the Southern District of New York are reported at 458 F.Supp. 143 (A 14a) and at 475 F.Supp. 1060 (A 22a).

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* References marked "A" are to pages in the attached Appendix.

Grounds on Which the Jurisdiction of This Court Is Invoked

The jurisdiction of this Court to review the judgment of the Court of Appeals is conferred by 28 U.S.C. §1254(1). The judgment of the Court of Appeals was entered on July 25, 1980 (A 1a). The Petitioner's timely petition for a rehearing was denied on September 9, 1980 (A 50a, 52a). This petition is filed within 90 days of that denial.

Statutory Provisions Involved

Receivership and liquidation provisions under the National Bank Act (12 U.S.C. §§ 192, 194 and 91) are set forth in the Appendix at 54a.

Statement of the Case

The issue in this case is whether this Court's Vanston/Fleming doctrine* is applicable to the federal receivership liquidation of an insolvent national bank under the National Bank Act. If the doctrine is applicable, it should rightly bar a secured creditor from receiving, from the wreck of an insolvent national bank, a post-insolvency interest profit far in excess of what it would have earned for itself if its debt had been paid earlier, when other creditors of the bank have been paid nothing. This is the first reported case ever to consider the question. The court below held, in error, that the doctrine was probably inapplicable to national bank insolvencies and in any event did not limit any part of the post-insolvency windfall being claimed here.

The facts are undisputed. Defendant Federal Reserve Bank of New York, a fully satisfied secured creditor of

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* *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946); *Fleming* v. *Traphagen*, 329 U.S. 686 (1946), described below at pp. 9-13.

the bankrupt bank, seeks $60.7 million of additional post-insolvency interest. This represents a windfall by way of a post-insolvency interest profit larger than that creditor would otherwise have earned on its funds during the three-year period they were outstanding. The unsecured creditors, who have not been paid even one cent against their debt of $60 million, urge that the "balance of equities between creditor and creditor" (*Vanston, supra,* 329 U.S. at 165) prohibits such a windfall.

The issue is of national importance because the unprecedented decision below, rejecting the applicability of Vanston/Fleming, will permit secured creditors to eat up the receivership estates of insolvent national banks with post-insolvency interest claims. This would make the equitable administration of those estates impossible. It would defeat the reasonable expectations of unsecured creditors of other national banks, holding claims in the billions, that at the very least no creditor is ever allowed to profit inequitably from an insolvency. It would also impose a chill on future unsecured financings of national banks, thus impairing a major source of new bank capital badly needed in the national interest. Resolution of the issue by this Court is essential to the determination of creditors' rights under the National Bank Act, including the related rights and duties of the Federal Reserve Bank and the Federal Deposit Insurance Corporation as secured lenders.

Summary of Undisputed Facts

The essential facts can be briefly stated. In 1974, Franklin National Bank collapsed into insolvency. From this disaster, defendant secured creditor has emerged unscathed. Indeed, after being repaid in full, it has already extracted a post-insolvency interest profit of $12.5 million more than it would otherwise have earned, and now seeks $60.7 million of further profit, at the expense of unsecured creditors who have received nothing.

In the five months immediately prior to the formal insolvency, defendant Federal Reserve shored up the Franklin bank with secured demand loans totalling (with pre-insolvency interest) some $1.7 billion. These funds were applied by the Franklin bank to pay the unsecured claims of other banks and short-term lenders, with the result that a major part of the bank's assets, with an aggregate face value of over $2.2 billion, ended up as collateral in the hands of Federal Reserve as secured lender. Unsecured loans, which would not have been entitled to any post-insolvency interest as against other creditors, were in this way converted into $1.7 billion of secured debt, with its attendant claim for an equitable amount of post-insolvency interest. The $1.7 billion included about $46 million of pre-insolvency interest; the entire $1.7 billion has since been repaid in full. The plaintiffs here are unsecured lenders, holding a total of some $60 million in public debentures, notes and other debt of the bank, no part of whose claims has been paid.

At the moment of insolvency, a deal was worked out between Federal Reserve as the secured lender, Federal Deposit Insurance Corporation as statutory receiver and insurer of the bank's insured depositors, and European-American Bank and Trust Co. Under that deal, European-American took over all of the insolvent bank's branch offices, its going business, FDIC-insured deposit liabilities, and selected assets, with the going concern value of the package being reflected by an excess of liabilities over assets (at book) of $125 million.

As part of the deal FDIC undertook a program of immediate liquidation of the bankrupt bank's remaining assets for the account of Federal Reserve as secured creditor. Proceeds collected by FDIC were to be forthwith paid over against the pre-insolvency amount due Federal Reserve ($1.7 billion). At the end of three years, FDIC guaranteed that it would itself pay the entire balance due Federal Reserve, plus post-insolvency simple interest of 7.52%, from

funds FDIC would provide for this purpose as a loan to the estate secured by the balance of the estate's assets.* In view of the FDIC guaranty, from the moment of insolvency Federal Reserve's loan to the insolvent bank was no longer at risk.

In October 1977, after three years of insolvency, the promised payment was made to Federal Reserve. As a result, Federal Reserve was repaid in full its entire $1.7 billion. It also received, in October 1977, post-insolvency simple interest totalling $218.9 million.

This interest return of $218.9 million was far in excess of what Federal Reserve would have earned on its usual investments during the three years its funds were outstanding. As the Chairman of the Federal Reserve Board personally confirmed to the Congress, the proper measure of Reserve Bank's normal interest return on its funds was the interest payable on three-month Treasury bills that it "would otherwise have purchased in the market" (JA.1343-44).** Using that measure, the $218.9 million exceeded its normal interest return, over the same period of time, by $12.5 million (JA.345 (¶67)). Thus Federal Reserve has already derived an interest profit from the misfortunes of the bankrupt estate.

Not satisfied with the profit to date, a greedy Federal Reserve seeks a "kicker" of another $60.7 million in post-insolvency interest, consisting of $30.5 million in simple interest for 1974 to 1977 and $30.2 million in interest upon interest for the same three years. This interest "kicker"

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* The FDIC loan provided for simple interest only, and a rate based on what FDIC would earn on its own funds. Since FDIC is not deriving either an interest windfall or interest upon interest, no issue has been raised regarding its post-insolvency charge to the estate.

** References marked "JA." are to the Joint Appendix of Exhibits on file in the court below. References marked "¶" are to Proposed Findings of Fact (set forth in JA. 303-362), most of which are uncontested.

was provided for in the agreement entered into by FDIC at the time of insolvency, but was not guaranteed by FDIC, which was unwilling to take the risk that the assets of the insolvent bank might prove insufficient to pay it. Instead, the "kicker" was to be paid only from those assets, if and when anything is left over after repayment of FDIC's advances and the expenses of liquidation.

The "kicker" threatens to consume the estate entirely, leaving nothing for any of the other creditors. Their contention is that the "balance of equities between creditor and creditor" (*Vanston, supra,* 329 U.S. at 165) mandates that the "kicker" be paid to Federal Reserve only out of any assets remaining after the other creditors have been paid. Federal Reserve, on the other hand, urges that it is entitled to its "kicker," and further profit, ahead of other creditors and without regard to whether this eats up the estate. In a nutshell, that is the issue in this case.

The Basis of Federal Jurisdiction in the District Court

Original federal jurisdiction in suits in equity is provided as against defendant Reserve Bank under 12 U.S.C. § 632, and as against defendant FDIC under 12 U.S.C. § 1819. In addition, original jurisdiction is separately conferred over any civil action to wind up the affairs of a national bank, under 28 U.S.C. § 1348.

THE REASONS FOR ALLOWANCE OF THE WRIT

I.

The Importance of the Issue

The Franklin collapse was the largest bank failure in U.S. history. The results of its liquidation, and in particular the outcome for the unsecured, uninsured public lenders to the bank, are being closely monitored by the entire banking and investment community. The refusal here to apply the Vanston/Fleming doctrine, and the resultant eating up of the estate by the highly profitable post-insolvency interest claims of the Federal Reserve, if allowed to stand, has these unfortunate results:

(1) The unprecedented decision below is the first ever to conclude that the Vanston/Fleming doctrine of equitable balancing of post-insolvency interest claims has no place in the FDIC receivership of an insolvent national bank under the National Bank Act. Those receiverships are, unfortunately, all too common an event. There have been 101 of them from 1934 through 1978 (*see* 1978 FDIC Annual Report 185). With mounting and rapidly oscillating interest rates a daily feature of our national life, the balancing of post-insolvency interest claims between creditors represents a major element in the outcome of any insolvency proceeding. This is particularly true in the federal receivership proceedings of national banks, which typically require many years for orderly liquidation of a complex asset portfolio (*see, e.g.*, JA.648-49). During those lengthy liquidation proceedings, post-insolvency interest claims could easily devour the bank's entire estate, if not equitably limited so as to avoid windfalls and apportion fairly the losses of the bank's failure. The correction by this Court of the error below is essential, we submit, to the proper administration of national bank receiverships on an equi-

table basis, including the rights and duties of Reserve Bank and FDIC as secured lenders.

(2) A major method for obtaining fresh bank capital in our country is by way of unsecured long term debt, of which the $60 million of Franklin unsecured notes and debentures is a prime example. The decision below casts a chill on any such financing, since any unsecured creditor would have to take into account the risk that the Federal Reserve or FDIC, coming in as secured creditors of an insolvent bank, could consume the estate with post-insolvency interest claims. Moreover, there is no offsetting economic benefit or efficiency, since secured debt is neither a common nor a practical method for obtaining public bank capital.

(3) The decision below defeats the reasonable expectations of unsecured bank lenders throughout the nation, holding billions of dollars in unsecured bank debt,* that in the event of bank insolvency they would receive protection under a Vanston/Fleming balance of equities, an expectation on which they—like the Franklin lenders—were entitled to rely.

(4) The decision below is unjust to some 1,000 public noteholders and other Franklin lenders, holding $60 million in unsecured Franklin debt.

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* *See* 66 Federal Reserve Bull. No. 10, Oct. 1980, A112.

II.

The decision below conflicts with applicable decisions of this Court requiring equitable balancing of post-insolvency interest claims of secured creditors in every type of federal insolvency proceeding.

It has long been settled law, in every type of federal insolvency proceeding, that unsecured creditors are barred from any post-insolvency interest until all creditors have been paid their principal in full. By requiring all general creditors to thus suffer the delays necessarily engendered by insolvency, and by preventing anyone from profiting from the shipwreck of the insolvency, the rule furthers elementary justice.

In the case of secured creditors, the problem has been a more difficult one. Their right to recover post-insolvency interest as well as principal from their collateral is clearly deserving of equitable recognition. Yet that right, equitable in origin, should also be subject to equitable balancing to make certain that the estate is not eaten up by inequitable post-insolvency interest claims. A settled line of decisions by this Court establishes that such equitable balancing is required, and imposes two limits on the post-insolvency interest claims of the secured creditor, namely, (i) interest upon post-insolvency interest is barred, and (ii) an interest return greater than the secured creditor would otherwise have enjoyed on its funds is also barred. *Vanston Bondholders Protective Committee* v. *Green,* 329 U.S. 156 (1946); *Fleming* v. *Traphagen,* 329 U.S. 686 (1946); *Sexton* v. *Dreyfus,* 219 U.S. 339 (1911); *Ticonic National Bank* v. *Sprague,* 303 U.S. 406 (1938). *Cf. Nicholas* v. *United States,* 384 U.S. 678, 683-84 (1966).

(a) *Vanston and Fleming*

In *Vanston, supra,* a public utility became insolvent in 1930. The proceeding commenced as a federal equity receivership, and subsequently shifted into a series of bank-

ruptcy reorganizations. The mortgage indenture provided for interest on any unpaid simple interest. The collateral proved to be sufficient to pay the principal and all post-insolvency interest, but simple interest payments were delayed until the 1940s. The secured creditors claimed, from their collateral, the interest upon unpaid interest specified by the indenture. So far as appears, unlike the present case no windfall profit was involved in that claim.* This Court held, both as to the period of the equity receivership and the subsequent bankruptcy, that the interest upon interest claim must be disallowed on equitable balancing grounds until subordinate creditors had first been paid.

The rule laid down in *Vanston* was broadly stated, and clearly intended for the guidance of the federal judiciary in all federal insolvency proceedings. Thus the opinion describes the rule as being applicable to "bankruptcy, receivership and reorganization" and, in a footnote, indicates that "analogous principles" also apply in national bank liquidations. 329 U.S. at 165 and n.7. The "touchstone" of decision on every claim for post-insolvency interest is described as "a balance of equities between creditor and creditor or between creditors and the debtor." 329 U.S. at 165.

The "balance of equities" touchstone announced in *Vanston* carries special force because this Court quite deliberately reached out to formulate it.** Moreover, in arriving at the "balance of equities" touchstone, *Vanston* undertook a searching analysis of the equitable principles

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* At one point the Court observes that payment of the claim would have "enriched" the *Vanston* secured creditors (329 U.S. at 166), but the term seems to be used literally rather than in any pejorative sense. The lengthy wait for simple interest involved in *Vanston* necessarily resulted in a massive reduction of the effective simple interest rate obtained by those secured creditors.

** The argument that the secured creditor's post-insolvency interest claim should be equitably limited as a matter of overriding federal law had not been considered below and had not been raised either in the *Vanston* briefs or in oral argument. *See* the

employed by this Court in earlier cases dealing with post-insolvency interest claims. The cases ranged over a variety of federal insolvency proceedings, including national bank liquidations. The analysis, while lengthy, is worth quoting from (329 U.S. at 163-65):

> "When and under what circumstances federal courts will allow interest on claims against debtors' estates being administered by them has long been decided by federal law. Cf. Board of Comm'rs of Jackson County v. United States, 308 U.S. 343; Royal Indemnity Co. v. United States, 313 U.S. 289. The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings. Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved.
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> Courts have felt that it would be inequitable for anyone to gain an advantage or suffer a loss because of such delay. Sexton v. Dreyfus, 219 U.S. 339, 346.
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> "Simple interest on secured claims accruing after the petition was filed was denied unless the security was

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Petition for Rehearing by Vanston Bondholders Protective Committee, 12/31/46, Oct. Term, 1946, Nos. 42, 43, at pp. 3, 5; Petition for Rehearing by Van Horn Bondholders Protective Committee, 1/3/47, Oct. Term, 1946, Nos. 44, 45, at pp. 2, 4.

The foregoing petitions requested a remand to the court below for a hearing on the factual issues seemingly suggested by the barring of interest upon interest under the "balance of equities". *Id.* The Court denied the petitions; two Justices (Frankfurter and Jackson) thought they should be granted. 329 U.S. 833 (1947). It would seem to follow that interest upon interest is barred *per se*, without regard to the circumstances.

worth more than the sum of principal and interest due. Sexton v. Dreyfus supra. To allow a secured creditor interest where his security was worth less than the value of his debt was thought to be inequitable to unsecured creditors. Thus we recently said: 'Since the distribution provided for these bonds on the basis of their mortgage securities is less than the principal amount of their claim, the limitation of their right to share the unmortgaged assets ratably with the unsecured creditors on the basis of principal and interest prior to bankruptcy only is justified under the rule of Ticonic National Bank v. Sprague, 303 U.S. 406. Group of Institutional Investors v. Chicago, Milwaukee St. Paul & Pacific R. Co., 318 U.S. 523, 573. But where an estate was ample to pay all creditors and to pay interest even after the petition was filed, equitable considerations were invoked to permit payment of this additional interest to the secured creditor rather than to the debtor. Coder v. Arts, 213 U.S. 223, 245; Sexton v. Dreyfus, supra. See also Johnson v. Norris, 190 F. 459.[7]

"It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor. See Sexton v. Dreyfus, supra, at 346."

"[7] Analogous principles have been applied to the liquidation of national banks. White v. Knox, 111 U.S. 784, 786, 787, relied on in Sexton v. Dreyfus, supra, 346; Ticonic Nat'l Bank v. Sprague, 303 U.S. 406, 412, 413."

The rule in *Vanston* was hammered home immediately in *Fleming, supra,* which was then pending before this Court. *Fleming* involved a railroad insolvency. The secured creditors held a mortgage on a railroad division which had earlier been a separate legal entity. The division, which was administered independently, produced more than enough earnings during the insolvency to pay both simple interest and the interest upon unpaid interest spe-

cified by the mortgage. In view of the profitable and separate nature of the division, the Circuit Court had upheld the claim for interest upon interest, pointing out that the secured creditors "are no part of the reorganization but constitute secured holders of instruments wholly unaffected thereby." 155 F.2d at 889-92. This Court summarily reversed, per curiam, citing the *Vanston* majority decision.* 329 U.S. 686. A petition seeking a hearing or remand on the applicability of the "balance of equities" test to *Fleming's* special facts was denied.** 329 U.S. 832. As in *Vanston,* the denial of any hearing or remand in *Fleming* would indicate that the condemnation of interest upon post-insolvency interest was on *per se* grounds. It also showed that the condemnation applied despite the separate nature of the *Fleming* collateral, which was no part of the bankruptcy reorganization.

As the lengthy quotation from *Vanston* set forth above demonstrates, the Vanston/Fleming doctrine was extrapolated from a series of earlier cases involving federal equity receiverships, straight bankruptcies, bankruptcy reorganizations, and national bank liquidations. Two of those earlier cases are of special significance here, and are discussed in detail below: *Sexton* v. *Dreyfus,* 219 U.S. 339 (1911) (cited five times in the passage from *Vanston* quoted above) and *Ticonic National Bank* v. *Sprague,* 303 U.S. 406 (1938) (cited twice).

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* A minority in *Vanston* (Justices Frankfurter and Jackson, joined by Justice Burton, who also concurred in the majority opinion) had concurred in the *Vanston* result on the ground that the provision for interest upon interest was invalid under state law. There was no minority opinion in *Fleming,* where the provision for interest upon interest was concededly valid under state law.

** Like the *Vanston* petitions, the *Fleming* petition pointed out that the question had never been brief or argued. The *Fleming* petition also urged a hearing on its special facts because *Vanston* had seemingly indicated that interest upon interest was inequitable only "under the circumstances shown by this [the Vanston] case" (329 U.S. at 163). *See* Petition of John C. Traphagen and Others for Hearing and Argument, 1/2/47, Oct. Term, 1946, No. 454, at pp. 2, 7.

(b) *Sexton* v. *Dreyfus*

In *Sexton,* the secured creditors of a straight bankrupt were in the possession of securities which had been pledged to them as collateral by the bankrupt. As in the instant case, their security fell outside the scope of the insolvency proceedings; the then bankruptcy statute provided explicitly that their liens were to be unaffected. *See* 219 U.S. at 343-44. The secured creditors proceeded with the sale of their collateral, diligently and fairly so far as appears, over a period of about one year. During that period they charged their post-insolvency interest against the proceeds of the collateral, and applied the balance of the collateral in partial reduction of principal. They then sought to prove the remaining unpaid principal as general creditors entitled to principal (but not to post-insolvency interest).

Both the District Court (per Learned Hand), 171 F. 751, and the majority of the Second Circuit, 180 F. 979, held that the secured creditors could recover their post-insolvency interest from their collateral, reasoning that they were entitled to the benefits of their security agreement outside the bankruptcy proceeding. On appeal the trustee in bankruptcy urged that payment of post-insolvency interest to secured creditors would violate the equities of the unsecured creditors, except perhaps as to the modest earnings derived by some of the collateral.

This Court, per Holmes, J., reversed, holding that the secured creditors were not entitled to marshal payment of post-insolvency interest against the proceeds of their collateral, except for the small earnings on the collateral,* on

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* In the instant case losses as well as earnings were experienced on the entire collateral package. Over the three years, net earnings on all the collateral, after losses, were only $183 million (*see* Pl's Ex. 113, pp. 4-6). Moreover, the collateral far exceeded the amount of the Federal Reserve's debt. In equity, applying the theory suggested by *Sexton,* it would seem that the net earnings from the collateral package should have been allocated in part to the excess collateral, of which the unsecured creditors were equitable owners; but in any event the Federal Reserve should

the theory that neither the secured creditors nor the estate should be allowed to "profit by the delay" in realizing on the collateral. 219 U.S. at 346. The Court noted that this result was "somewhat sustained by analogy in the case of insolvent banks." 219 U.S. at 346.

While Mr. Justice Holmes' opinion in *Sexton* is typically succinct, it is clear that he was balancing the equities between the secured and unsecured creditors. The ideal result, he pointed out, would be to have "the whole matter . . . settled in a day by a pie-powder court, the secured creditor would be called upon to sell or have his security valued on the spot, would receive a dividend upon that footing, would suffer no injustice, and could not complain." (219 U.S. at 344-45).* Of course, the delays necessarily engendered by insolvency make that ideal result impossible. In *Sexton,* those delays benefited the secured creditors (and to a lesser extent, the estate) "because of the hope of getting a higher price" (219 U.S. at 345); on the other hand, the same delays produced some small earnings from the collateral during a period when the secured creditors were being deprived of any return. Balancing these equities, this Court denied any post-insolvency interest except for the earnings, so that neither side would "profit by the delay". 219 U.S. at 346 (the phrase is echoed in *Vanston,* 329 U.S. at 164; the same page in *Sexton* is also cited again in *Vanston* as supporting the "balance of equities" test, 329 U.S. at 165).

The equitable principles announced by Mr. Justice Holmes in *Sexton* continue to have vitality today. *See, e.g.,*

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have been limited to no more than what it would otherwise have earned on its own funds while they were outstanding, i.e., $12.5 million less than the $218.9 million of post-insolvency interest already paid to it (*supra,* p. 5).

* Similarly here, if the secured creditor had received its $1.7 billion on day one of the insolvency, it would have earned, in the ensuing three years, far less than it is now claiming, "would suffer no injustice, and could not complain." What would Mr. Justice Holmes have thought of a secured creditor who seeks a larger interest return from the wreck of insolvency than it would have earned if its debt had been paid?

New York v. *Saper*, 336 U.S. 328, 330 and n.7 (1949) (*Sexton* followed in disallowing post-bankruptcy interest for tax liens); *Nicholas* v. *United States*, 384 U.S. 678, 683-84 (1966) (same as to taxes incurred after bankruptcy petition filed). Indeed, the Court's relatively recent review of these principles in *Nicholas* expressly rested on *Sexton* as well as *Vanston* in reaffirming "the broad equitable principle that creditors should not be disadvantaged vis-à-vis one another by legal delays", a principle which "rests at bottom on an awareness of the inequity that would result" if continuing accumulations of post-bankruptcy interest were permitted "to absorb the assets of a bankrupt estate whose funds were already inadequate to pay the principal of the debt owed by the estate." 384 U.S. at 683-84 and nn. 11 & 12.

(c) *Ticonic National Bank* v. *Sprague*

In *Ticonic*, twenty-seven years after *Sexton*, this Court turned to the issue of post-insolvency interest for secured creditors of a national bank. By then it was clear that in bankruptcy secured creditors could ordinarily recover post-insolvency simple interest from their collateral if it was sufficient to pay principal as well as interest. A number of Circuit Courts had held, nevertheless, that the National Bank Act called for total elimination of all post-insolvency interest. Those Circuit Court decisions were overruled in *Ticonic*, which concluded that the same rule regarding post-insolvency interest claims of secured creditors should be applied both in bankruptcy and in a national bank insolvency because they constituted "analogous liquidations". 303 U.S. at 413. In reaching this result the *Ticonic* court indicated that the insolvency rules of the National Bank Act were essentially equitable in nature, and that in equity secured creditors were generally entitled to be treated more favorably than unsecured creditors. 303 U.S. at 412. These pages of the *Ticonic* decision are cited in *Vanston*, 329 U.S. at 165, n.7, for the proposition that "[a]nalogous principles" apply under the National Bank Act.

There was, of course, no suggestion whatever in *Ticonic* that the secured creditor was seeking an interest return greater than it would have earned on its money if paid, or that the interest being claimed was otherwise inequitable. Indeed, it appears that the interest rate allowed in *Ticonic* (on a trust fund accepted by the bank for investment) was the legal rate,* which would presumably have been simple interest in a low amount. In short, like *Sexton*, *Ticonic* can be viewed—as *Vanston* clearly saw it—as illustrating the application of broad equitable principles to the post-insolvency interest claims of secured creditors. (*See, e.g.*, *Ticonic*, 303 U.S. at 414 (equitable factors discussed); *Vanston*, citing *Ticonic*, 329 U.S. at 164, 165 n.7.)

Notwithstanding *Vanston's* reliance on *Ticonic*, the decision below in the instant case erroneously concludes that *Ticonic* establishes a special rule for national bank liquidations which permits a departure from *Vanston* (A8a, 9a, 10a, 11a). This overlooks the express resort in *Ticonic* itself to equitable principles in deciding to treat national bank liquidations in a manner consistent with "analogous" bankruptcy liquidations. It also narrows impermissibly the scope of the *Vanston* rule.

Vanston itself had initially involved a federal equity receivership. Such a receivership operates in the same manner as the statutory receivership prescribed under the National Bank Act. Moreover, *Vanston* extrapolated its equitable balancing principle from all types of insolvency cases, including not only federal equity receiverships but also national bank receiverships, and specifically justified its resort to national bank precedents on the ground that they involved "[a]nalogous principles" (329 U.S. at 165 n.7; compare the misreading of *Vanston's* n.7 in the instant opinion below at A8a).

In concluding that *Ticonic* somehow bars the Vanston/Fleming doctrine for national bank receiverships, the opin-

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* *See* Brief of Petitioner in *Ticonic*, Oct. Term, 1937 at p. 20.

ion below overlooks the fact that in one vital respect the two insolvency systems have long had the same basic equitable rule with respect to interest: payment of the post-insolvency interest claims of unsecured creditors, whether in bankruptcy or national bank receiverships, is prohibited until principal has been paid in full.* In both systems the allowance of secured creditors' post-insolvency interest claims developed as a special equitable exception to this basic prohibition.** Recognizing the equitable nature of this exception, *Vanston* established the principle that equitable balancing was appropriate to limit it. That principle is equally valid for both systems.

III.

The decision below erred in concluding that *Vanston* is inapplicable to national bank insolvencies.

The decision below suggests neither an equitable nor a policy reason for limiting equitable balancing of post-insolvency interest claims to insolvencies governed by the Bankruptcy Act. The National Bank Act is, of course, a different statutory scheme; but its "ratable" distribution procedures have long been viewed as embodying equitable principles, as Mr. Justice Frankfurter pointed out in *American Surety Co.* v. *Bethlehem Nat. Bank*, 314 U.S. 314, 316-17 (1941):

> "The National Bank Act provides for the 'ratable' distribution of assets of insolvent national banks. [Statute cited.] The question for decision is therefore one of federal law. [Citations omitted.] Congress has seen fit not to anticipate by specific rules solution of problems that inevitably arise in national bank liquidations. Instead, it chose achievement of a 'just and equal

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* *Vanston, supra*, 329 U.S. at 163-64; *Ticonic, supra*, 303 U.S. at 411; *see Nicholas, supra*, 384 U.S. at 682-84.

** *Vanston, supra*, 329 U.S. at 164-65; *Ticonic, supra*, 303 U.S. at 412, 413; *Sexton, supra*, 219 U.S. at 346.

> distribution' of an insolvent bank's assets through the operation of familiar equitable doctrines evolved by the courts. *Davis* v. *Elmira Sav. Bank*, 161 U.S. 275, 284; *Jenkins* v. *National Surety Co.*, 277 U.S. 258, 267."

Bankruptcy has no monopoly on equity. Indeed, a rich source of equitable insolvency principles has always been found in national bank insolvency cases. *Vanston* itself demonstrates this by relying on two national bank cases in arriving at its equitable balancing doctrines: *Ticonic, supra,* and *White* v. *Knox*, 111 U.S. 784 (1884). *See Vanston, supra,* 329 U.S. at 164, 165 n.7.

National bank liquidations have sometimes departed from bankruptcy rules, but never from equitable principles. For example, in *Merrill* v. *National Bank of Jacksonville*, 173 U.S. 131 (1899), a bare majority of the Justices deliberately departed from a bankruptcy rule, dealing with the marshaling of collateral, in favor of the English equity or "chancery" rule. In reaching this result, however, the Court stressed the special importance of equitable considerations in national bank receiverships, which justified a rule with *more* equity than that presented by the statutory bankruptcy rule. 173 U.S. at 138, 146.*

The decision below has also suggested that *Vanston* may be peculiar to reorganizations in bankruptcy, on the theory that "special equity considerations are in play" there (A8a). This disregards the specific reference in *Vanston* itself to "bankruptcy" as well as "reorganization" *(supra)*. It also disregards the settled line of cases which have ap-

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* *Merrill* was decided over the vigorous dissent of four Justices (173 U.S. at 147, 172) and has since been criticized as an historical anomaly. *See* dissenting opinion of Mr. Justice Douglas in *American Surety Co., supra,* 314 U.S. at 319; Clark, *Proof by Secured Creditors in Insolvency and Receivership Proceedings*, 15 Ill. L. Rev. 171 (1920). The *Merrill* dissenters, and their later supporters, stressed the importance of consistency between the two insolvency statutes and in any event considered the bankruptcy rule to have the greater equity.

plied *Vanston* and its progeny to straight bankruptcy liquidations on the ground that, in those liquidations, equitable limitations on post-insolvency interest claims are especially appropriate to assure that the "already inadequate" estate will not be eaten up with the "continuing accumulation" of interest. *Nicholas, supra,* 384 U.S. at 683-84.*

As another indicated ground for rejecting *Vanston* here, the decision below pointed out that the National Bank Act calls for "ratable" distributions to creditors, and contrasted this with the "fair and equitable" language of the Bankruptcy Act's reorganization provisions (A8a). There is no merit to the suggestion that the term "ratable" precludes the balancing of equities between creditors. As already noted (*supra* p. 18), Mr. Justice Frankfurter treated the term "ratable" in the National Bank Act as contemplating "just and equal distribution" to be achieved "through familiar equitable doctrines evolved by the court." *American Surety Co., supra,* 314 U.S. at 316. Similarly, in *Scott* v.

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* The equitable balancing between creditors required by *Vanston* is pertinent whether the delays attendant upon insolvency are the result of reorganization or straight bankruptcy liquidation. For example, it is well settled that the suspension of all post-insolvency interest on pre-insolvency tax claims—an outgrowth of the *Vanston* doctrine—applies in straight bankruptcy as well as in reorganization. *E.g., New York* v. *Saper,* 336 U.S. 328 (1949) (straight bankruptcy); *United States* v. *Edens,* 189 F.2d 876, 877-78 (4th Cir. 1951), *aff'd per curiam,* 342 U.S. 912 (1952) (equitable considerations for denying post-insolvency interest on tax claims are "as strong" in reorganization as in straight bankruptcy).

In *Nicholas, supra,* 384 U.S. 678 (1966), the issue presented was whether, under *Saper,* interest on taxes incurred during reorganization could continue to run during a subsequent straight bankruptcy. This Court held that equitable rights of other creditors required suspension of the government's claim for interest during the straight bankruptcy.

Lower court opinions have similarly recognized the applicability of the *Vanston* doctrine to straight bankruptcy liquidations. *E.g., In re Magnus Harmonica Corp.,* 262 F.2d 515 (3d Cir. 1959); *Northtown Theatre Corp.* v. *Mickelson,* 226 F.2d 212 (8th Cir. 1955).

Armstrong, 146 U.S. 499, 510-11 (1892), this Court, per Mr. Justic Fuller, observed that "ratable" in the National Bank Act was "nothing new", but rather echoed the language of the early English Bankruptcy Act of 13 Eliz. chap. 7 ("rate and rate alike"), where equities between creditors had traditionally been considered. Accordingly this Court held that the "ratable" language of the National Bank Act clearly invoked "natural justice" and "equity" in permitting an equitable set-off. *Id.* at 508.

Finally, the decision below suggests that *Vanston* may have no place in national bank receiverships because the doctrine is grounded on the "custodia legis" which is provided for the bankrupt estate by the Bankruptcy Act (A7a-8a). The theory appears to be that under the National Bank Act a secured creditor is free to take possession of his collateral and dispose of it without judicial restraint (A9a). This is an erroneous limitation of the equitable powers of a national bank receiver, and one which is particularly unfortunate from the point of view of future administration of the National Bank Act.

Under that Act, the statutory receiver of the insolvent national bank is directed to take possession of its "assets of every description", collect "all debts, dues, and claims belonging to it," and, upon court order, may sell "all" its property, following which a "ratable dividend" is to be paid on all proven or adjudicated claims; preferences are "null and void", and "no attachment, injunction or execution" may issue against the bank "or its property" before final judgment. 12 U.S.C. §§ 192, 194, 91.

This statutory language is certainly broad enough to vest in the receiver the entire equity of redemption in any excess collateral held by a secured creditor. At the moment of insolvency that collateral is under equitable co-ownership: the portion which equals the secured creditor's pre-insolvency claim is equitably owned by him, and the balance is equitably owned by the receiver in trust for the entire

estate. Any attempt by the secured creditor to dispose of the collateral in an unreasonable or unfair manner to his own selfish advantage and to the detriment of his co-owner would justifiably be subject to equitable restraint by a court acting at the receiver's instance. This produces, in practical effect, the same result as the "custodia legis" of a bankruptcy court, to the same beneficial, equitable end: orderly realization upon the values inherent in the insolvent estate, in the interests of the estate and all its creditors.

In short, the case for the Vanston/Fleming doctrine is even stronger in a national bank receivership than in bankruptcy. The statutory scheme of the National Bank Act is more flexible and susceptible to "equitable doctrines evolved by the courts", in the interest of "just and equal distribution." *American Surety Co., supra,* 314 U.S. at 316-17. Federal law is more clearly applicable to the competing rights of national bank creditors.* Equity is stronger and more traditional in national bank receiverships. We submit that correction of the contrary view below is a matter of overriding public importance in the equitable administration of interest claims in national bank receiverships.

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* As to the argument that *Vanston* improperly invades creditors' rights governed by state law, compare the concurring view of Frankfurter, J., in *Vanston,* 329 U.S. at 167.

IV.

Vanston bars a secured creditor from a windfall interest profit, and from interest upon interest, when other creditors have not been paid.

The decision below has also ruled, erroneously, that the principles of *Vanston* do not "suggest any impropriety" here, and especially so in the "light of" *Ticonic** (A9a). No mention is made, however, of the two undisputed facts that are critical to the balancing of equities under *Vanston:* (1) the secured creditor's funds were never at risk during the insolvency, because of the unconditional undertaking furnished to it by another government agency of unquestioned solvency (the FDIC), and (2) the secured creditor has already derived a post-insolvency interest return on its funds, during the three years they were outstanding, which exceeds what it would have earned on its usual investments during that period.

One can only assume that the decision below ignored the undisputed fact of a windfall return because there was no "impropriety" involved. But the test under *Vanston* is not one of impropriety. In *Vanston* itself, for example, there was no impropriety presented by a claim for interest made in accordance with the express terms of a mortgage indenture which had been negotiated at arm's length, in the market place, in return for valid consideration. Notwithstanding the clear propriety of such a claim *Vanston* nevertheless determined that the secured creditor was not equitably entitled to retain the benefits of its bargain and gain from the insolvency at the expense of the junior creditors.

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* While the decision below here seems to assume that *Vanston* may possibly be applicable to national bank receiverships, it qualifies this by invoking *Ticonic* as permitting free rein to the secured creditor's post-insolvency interest claims (A9a-10a). As shown above, this view of *Ticonic* is clearly in error (*supra*, pp. 17-18).

That is exactly what has happened here; indeed, windfall gain to this secured creditor is far clearer than it was in *Vanston* (where the secured creditor evidently was at risk throughout the insolvency and experienced an interest loss rather than an interest profit).

The decision below suggests only one equitable consideration in favor of the secured creditor: the interest being claimed was the product of a so-called "forebearance agreement", entered with the secured creditor at the moment of insolvency, which supposedly conferred a substantial benefit upon the insolvent estate (A9a). However, the supposed benefit has as yet not produced any payments to junior creditors.* At least until all creditors are paid there can be no conceivable justification for permitting a windfall interest profit to any creditor.

The equities might well be different, if the cleverly-styled "forebearance agreement" had actually resulted in a detriment or loss of some kind to the secured creditor; in such a case the additional interest might be viewed as an offset against the loss, rather than a pure windfall. The undisputed fact, however, is to the contrary. Under the "forebearance agreement", in exchange for surrendering its lien on the collateral, the secured creditor received an unconditional undertaking by another government agency (the FDIC) to pay in full, at the end of the first three years of insolvency, the secured creditor's entire pre-insolvency claim ($1.7 billion), plus post-insolvency interest ($218.9 million). That agency, an acknowledged expert in the liquidation of national banks, also undertook to handle the liquidation of all remaining assets of the insolvent bank and, after provision only for expenses, to apply those proceeds forthwith towards repayment of the

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* The supposed benefit consisted of helping the insolvent bank to realize, through a sale to another bank, on the good will value of its own business. That benefit, however, will be eaten up by the secured creditors' interest claim.

secured creditor. Thus the mis-named "forbearance" meant, insofar as the secured creditor was concerned, that during the three years it would receive payment with all possible speed and would have no further need to concern itself with the enormous task of liquidating its complex, world-wide portfolio of collateral.*

In short, the "forebearance agreement" presented clear benefits to the secured creditor by assuring both speedy collection and full payment of its funds. There were no detriments which would justify a windfall return. The inequity of permitting such enrichment at the expense of other creditors is manifest.

The decision below also seems to suggest (A4a, 9a) that some preclusive weight should be given to an ex parte order which was issued by the District Court at the moment of insolvency. That order did not purport to deal with the rights of junior creditors. It was issued pursuant to the procedures prescribed by *Hulse* v. *Argetsinger*, 18

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* The decision below appears to have assumed that the "forebearance agreement" somehow resulted in slower payment to the secured creditor over the three years than would have been the case if it had realized on its collateral for itself (A4a, 9a). The evidence clearly demonstrates that the contrary is the case and payments were actually speeded up during the three years. On this point, FDIC Chairman Wille testified (JA. 648-49):

> "Q. Did you at that time while you were considering the assumption agreement, did you or your staff make any determination of the time it would have taken for the Federal Reserve Bank of New York to liquidate its collateral in the event that the FDIC did not assume this loan or pay it off?
>
> "A. We had nothing to go on to answer that question, Mr. Finkelstein, by way of experience except our own, and we rather doubted that the Federal Reserve system would have been as successful in liquidating it as promptly as the FDIC because of their lack of experience in the liquidation of any collateral emergency loans."

In any event, even assuming there were a delay in liquidating the collateral, the secured creditor suffered no detriment, since the interest already paid to it exceeds what it would have earned on its money over the same time period.

F.2d 944 (2d Cir. 1927) which calls for no notice, no hearing, no evidence, no record in the usual sense, and no appeal. As *Hulse* makes clear, such a procedure is "visitatorial" in nature rather than judicial, does not adjudicate "any rights inter partes", and in no way bars a subsequent plenary proceeding to determine rights of creditors or others. *Id.* at 945.

Finally, the court below erred in concluding that the "compounding formula" for calculating interest upon interest somehow did not constitute interest upon interest within the bar of *Vanston* (A12a-13a n.5). The interest "kicker" consists of (i) $30.5 million in additional simple interest and (ii) $30.2 million in interest upon all unpaid interest ($11 million for year 2 and $19.2 million for year 3). The huge amount of interest upon interest reflects the charge imposed for waiting until year 3 for final payment, a delay inherent in the insolvency. Imposition of a charge by reason of delay in the payment of post-insolvency interest is precisely the practice barred in *Vanston*. The court below seems to have been beguiled by the fact that the further accrual of interest upon interest was halted upon final payment at the end of year three. This does not alter the unlawful nature of the charge imposed for waiting three years. If ten years' worth of interest upon post-insolvency interest is illegal, as it was in *Vanston*, then so is three years' worth.

V.

The time is ripe for a reaffirmation of the applicability of Vanston/Fleming to national bank insolvencies.

Thirty-four years have passed since *Vanston* and *Fleming*. During that time their doctrine has been affirmed time and time again by the lower courts, as follows:

(i) In a contest between creditors the doctrine bars any claim by a secured creditor for interest upon post-insolvency interest.

> *E.g., In re Black Ranches, Inc.*, 362 F.2d 8, 15 n.10 (8th Cir.), cert. denied, 385 U.S. 990 (1966); *In re Leeds Homes, Inc.*, 222 F.Supp. 20, 32 (E.D. Tenn. 1963), aff'd, 332 F.2d 648 (6th Cir.), cert. denied, 379 U.S. 836 (1964); *In re Schafer's Bakeries*, 155 F.Supp. 902, 912-14 (E.D. Mich. 1957), app. denied, 249 F.2d 448 (6th Cir. 1957); *Collier on Bankruptcy*, 14th Ed. 1978, Vol. 3A, §63.16, at p. 1863, and Vol. 6, §9.08, n.23 at p. 1575.

(ii) In a contest between creditors, the doctrine also bars a secured lender's claim for excessive or otherwise inequitable post-insolvency simple interest.

> *In re Leeds Homes, Inc.*, 222 F.Supp. 20, 31-33 (E.D. Tenn. 1963), aff'd, 332 F.2d 648 (6th Cir.), cert. denied, 379 U.S. 836 (1964); *In re Magnus Harmonica Corp.*, 262 F.2d 515, 518 (3d Cir. 1959); *United States Trust Company* v. *Zelle*, 191 F.2d 822, 824-26 (8th Cir. 1951), cert. denied, 342 U.S. 944 (1952); *Northtown Theatre Corp.* v. *Mickelson*, 226 F.2d 212, 215 (8th Cir. 1955); *Pacific States Corp.* v. *Hall*, 166 F.2d 668, 672 (9th Cir. 1948); *In re Brown*, 94 F.Supp. 259, 261-62 (N.D.N.Y. 1950); 8A C.J.S. Bankruptcy § 242(8).

(iii) If, however, a high risk secured lender has shaky collateral and would normally receive a high return for his

risk, a higher amount of post-insolvency simple interest may be equitably justified.

> *In re Schrader Body, Inc.*, 315 F.Supp. 1349 (W.D. Pa. 1970); *In re Advance Printing and Litho Co.*, 277 F.Supp. 101 (W.D. Pa.), *aff'd*, 387 F.2d 952 (3d Cir. 1967). Compare *In re Elkins-Dell Mfg. Co.*, 253 F. Supp. 864 (E.D. Pa. 1966).

But even a high risk secured lender can be subject to *Vanston* disallowance of simple interest.

> See, e.g., *In re Schafer's Bakeries*, 155 F.Supp. 902, 912-14 (E.D. Mich. 1957) (additional simple interest, as well as interest on interest, disallowed where commercial financing secured lender "has already received simple interest on these loans and has been well recompensed for the use of its money").

(iv) If the contest is between creditors and a solvent debtor, the equities favor the creditors and post-insolvency interest claims (including, according to some authority, even interest on interest) are generally allowed.

> E.g., *In re Maryvale Community Hospital Inc.*, 456 F.2d 410, 413 (9th Cir. 1972) (compound interest); *Ruskin* v. *Griffiths*, 269 F.2d 827, 830-33 (2d Cir. 1959) (simple interest), cert. denied, 361 U.S. 947 (1960); *Georgia, Florida & Alabama R. Co.* v. *Bankers Trust Co.*, 170 F.2d 733, 734-35 (5th Cir. 1948) (simple interest only, as court stresses).

So far as we can determine, the landmark decision below is the first ever to consider the applicability of Vanston/Fleming equitable principles under the National Bank Act. The erroneous rejection of those principles will have unfortunate consequences for the entire banking and financial community. The time is clearly ripe for a reaffirmation by this Court that Vanston/Fleming are equally valid and

applicable in the equitable administration of national bank insolvencies.

CONCLUSION

For these reasons, a writ of certiorari should be issued to review the judgment of the Second Circuit.

December 8, 1980

Respectfully submitted,

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APPENDIX A

Court of Appeals Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 850, 1048—September Term, 1979

(Argued May 19, 1980 Decided July 25, 1980)

Docket Nos. 79-7702-03

SOL NEIL CORBIN, as Trustee in Bankruptcy of Franklin New York Corporation,

Plaintiff-Appellant,

and

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, BERKSHIRE LIFE INSURANCE COMPANY, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY, THE MINNESOTA MUTUAL LIFE INSURANCE COMPANY, MORGAN GUARANTY TRUST CO., as Trustee, NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY, OCCIDENTAL LIFE INSURANCE COMPANY OF CALIFORNIA, THE PENN MUTUAL LIFE INSURANCE COMPANY, SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM, SHELL PENSION TRUST, SOUTHLAND LIFE INSURANCE COMPANY, STATE OF WISCONSIN INVESTMENT BOARD, UNITED CALIFORNIA BANK, as Trustee, UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee, and WESTERN LIFE INSURANCE COMPANY,

Plaintiff-Intervenors-Appellants,

v.

FEDERAL RESERVE BANK OF NEW YORK AND FEDERAL DEPOSIT INSURANCE CORPORATION, in its Corporate Capacity and as Receiver of Franklin National Bank,

Defendants-Appellees.

B e f o r e :

OAKES and MESKILL, *Circuit Judges,*
and BONSAL, *District Judge.**

Appeal from a decision of the United States District Court for the Southern District of New York, Milton Pollack, *Judge,* in a suit by certain unsecured creditors of Franklin National Bank seeking a reduction in the interest owed by Franklin to a secured creditor, the Federal Reserve Bank of New York. The district court upheld these interest obligations, which were established by an agreement growing out of the bank's insolvency. The judgment is affirmed substantially on the opinion below.

DAVID SIMON, New York, N.Y. (Barrett Smith Schapiro Simon & Armstrong, Michael O. Finkelstein, Joel M. Gross,

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* Senior District Judge of the United States District Court for the Southern District of New York, sitting by designation.

Eric J. Anderson, of counsel), *for Appellant Corbin.*

ROBERT L. KING, New York, N.Y. (Debevoise, Plimpton, Lyons & Gates, Sally D. Turner, of counsel), *for Appellants Connecticut General Life Insurance Co., et al.*

WILLIAM E. HEGARTY, New York, N.Y. (Cahill, Gordon & Reindel, Allen S. Joslyn, Michael P. Tierney, Patricia A. Pickrel, of counsel), *for Appellee Federal Reserve Bank of New York.*

WILLIAM E. KELLY, New York, N.Y. (Casey, Lane & Mittendorf, Alan R. Wentzel, Christopher R. Belmonte, of counsel), *for Appellee Federal Deposit Insurance Corporation.*

OAKES, *Circuit Judge:*

This is an appeal by certain unsecured creditors of Franklin National Bank (FNB) from a judgment of the United States District Court for the Southern District of New York, Milton Pollack, Judge, with opinion reported at 475 F. Supp. 1060 (S.D.N.Y. 1979). Among these appellants is the trustee in bankruptcy of Franklin New York Corporation (FNYC). As the holding company of FNB—a bank whose 1974 insolvency has spawned considerable litigation—FNYC is not only an FNB creditor but also the owner of all outstanding FNB stock (except directors' qualifying shares). The remaining appellants are intervenors who hold subordinated FNB debentures.

This suit sought a reduction in the interest payable to the Federal Reserve Bank of New York (FRB) out of the FNB estate—interest owed under the terms of FRB's agreement to forbear for three years from the collection of a past-due $1.7 billion secured debt of FNB. The $1.7 billion debt resulted from FRB's efforts to shore up FNB during the summer of 1974 through emergency, short-term loans. The agreement to delay collection of this debt was part of a set of arrangements by the Federal Deposit Insurance Corporation (FDIC) that forestalled an immediate closing of the bank. These arrangements were made with prior judicial approval, *In re Franklin National Bank*, 381 F. Supp. 1390 (E.D.N.Y. 1974), which is required where, as here, the FDIC acting as receiver of a bank decides to purchase and liquidate or to sell the bank's assets, 12 U.S.C. § 1823(d). Here, the arrangements made involved a transfer of some of FNB's assets and liabilities to the European-American Bank, plus a sale of the remaining assets to FDIC in its "corporate" capacity, which agreed to pay off the remaining liabilities as it liquidated the assets. Appellant's basic claim is that FRB had too much of the best side of this deal.

Judge Pollack's earlier opinion, reported in 458 F. Supp. 143 (S.D.N.Y. 1978), denying a motion to dismiss the complaint, adequately answers the contentions of FRB and FDIC that the court lacked subject matter jurisdiction, that FDIC had sovereign immunity, and that the Trustee of FNYC lacked standing to complain of FDIC's acts as Receiver of FNB, and we affirm so much of the judgment as relates thereto on that opinion.[1] The principal arguments remaining are those

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1 Judge Pollack also held in this opinion that, although the "statutes do give FDIC *in its corporate capacity* the discretion to set the terms

of appellants on the merits, *viz.*, that $60.7 million of interest payable under the forbearance agreement to FRB should be disallowed under the doctrine of *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156 (1946), and progeny, and that FDIC as Receiver breached its fiduciary duty. *Vanston* held that it was inequitable for a debtor in reorganization to be required to pay interest on interest, when simple interest payments on mortgage indentures had been suspended by court order. *Id.* at 165. The claim under *Vanston* here is that $30.2 million of the interest sought by FRB is similarly unlawful interest upon post-insolvency interest, and that the entire $60.7 million at stake represents an unlawful windfall, contrary to the balance of equities. The fiduciary duty argument focuses more generally on the structure of the deal as a whole.

The factual and commercial background, and the fiduciary duty argument, are more than adequately set forth and dealt with in Judge Pollack's second opinion, 475 F. Supp. 1060 (S.D.N.Y. 1979), which is incorporated here by reference. We substantially affirm on

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and conditions of a purchase of assets from itself as a Receiver (12 U.S.C. §§ 1823(d) and (e))." 458 F. Supp. at 146, the fairness of the actions of the *Receiver* in such a transaction is "not beyond the scope of traditional judicial review," *id.* We find this question of the appropriate scope of review of the Receiver's actions to be a vexing one. The FDIC is clearly authorized by statute to play a dual role in these transactions, and to consider, in addition to the interests of creditors, its own welfare and that of the economy as a whole. These facts argue against any searching judicial review. On the other hand, creditors may be insufficiently protected if the Receiver's actions are only tested under an abuse of discretion standard, or are not reviewed at all. We need not decide this issue here since we agree with Judge Pollack's second opinion, 475 F. Supp. 1060 (S.D.N.Y. 1979), holding that the present arrangements survive even "traditional judicial review."

that opinion,[2] merely taking this opportunity to explore a little further the *Vanston* arguments of appellants. The interest arrangements required payment to FRB after three years of simple interest at a fixed rate of 7.52% for the three years during which full repayment was deferred (less an adjustment for liquidation expense), with the FDIC guaranteeing payment of this amount. This sum has been paid and is not challenged here. An additional amount of interest—contingent on the availability of funds in the estate—was also required. This extra interest increased the rate from 7.52% to 8.5%, compounded annually, but with payment delayed until funds became available. Essentially Judge Pollack held that these arrangements were not unfair. 475 F. Supp. at 1068-70. More specifically, he held that they did not involve improper self-dealing or a breach of fiduciary duty on the part of FDIC (in the light of the statutory contemplated duality of its role), *id.* at 1070, and as to the *Vanston* argument said:

> Even if the recoupment provision were to be deemed an agreement to pay compound interest, there is no general federal policy or rule of law against an agreement to pay compound interest on obligations incurred by National Banks or their receivers with a Federal Reserve Bank. In particular, the case relied on by plaintiff, *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 67 S.Ct. 237, 91 L. Ed. 162 (1946), does not establish any rule applicable herein. *Vanston*'s disapproval in a reorganization proceeding of a pre-insolvency agreement to pay interest on unpaid

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2 *See* note 1 *supra.*

> interest is of no relevance to the instant review of the post-insolvency agreement made by the Receiver in the course of its obligations under the federal banking laws to wind up the affairs of an insolvent National Bank. At most, the equitable principles invoked in *Vanston* merely sanction the review of the agreement which has been conducted herein; they do not condemn compound interest in all circumstances and do not preclude this Court's finding that the agreement was fair and appropriate.

Id. at 1071.

Appellants argue that *Vanston* applies to all insolvencies, including those of national banks, and that the "'touchstone'" is to "achieve a 'balance of equities between creditors and creditor or between creditors and [the] debtor.'" Brief of Appellant Corbin at 23-24 (quoting *Vanston, supra,* 329 U.S. at 165). They also claim that *Vanston* and progeny require the conclusion that "interest upon post-insolvency interest is *per se* unlawful if it results from insolvency-engendered delays and deprives other creditors." *Id.* at 2.

First, it is not at all clear that *Vanston* has any application to this case. That case was decided under the Bankruptcy Act, which explicitly exempts banks from its provisions. 11 U.S.C. § 22 (1976).[3] This exemption has important consequences. The assets of a debtor in reorganization or in liquidation, unlike those of a bank in receivership, are in the custody of the

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3 The revised Bankruptcy Act also contains this exclusion, in 11 U.S.C. § 109(b)(2) (1979). Other references to the Bankruptcy Act in this opinion are to the old act.

court. *Id.* §§ 11, 516. The court, in reorganization proceedings like that in *Vanston,* has a duty to approve and confirm only those plans that are "fair and equitable." *Id.* §§ 574, 621(2). This fairness concept has a distinct statutory function in the context of reorganization in that it is related to the provision that a court may stay enforcement of a lien, *id.* § 513, and may materially and adversely affect a claimant's rights if two-thirds of the claimants in the same class agree, *id.* § 579. Speaking more generally, it is clear that special equity considerations are in play in a reorganization proceeding, where the goal is to restore a corporation to health by altering arrangements with its creditors and stockholders, but without neglecting the relative positions of these parties beforehand. *See generally* 6 *Collier on Bankruptcy* ¶ 0.09 (1978). Because the powers and goals of a bank receiver are quite different, equitable principles developed in the reorganization context cannot simply be grafted onto the national banking statutes. *See In re Stirling Homex Corp.,* 579 F.2d 206, 211 n.8 (2d Cir. 1978), *cert. denied,* 439 U.S. 1074 (1979) (the National Bank Act is "an entirely different statutory scheme . . . under which distribution is to be 'ratable' rather than 'fair and equitable' "). In sum, while the landmark case of *Ticonic National Bank v. Sprague,* 303 U.S. 406 (1938) (establishing the rule that in a distribution of bank assets, a secured creditor can receive even post-insolvency interest up to the amount of the assets covered by his lien), is referred to in *Vanston,* 329 U.S. at 164, 165 n.7, it does not follow that the same rules that apply in bankruptcy necessarily apply in national bank receiverships.

In addition, the principles enunciated in *Vanston* do not, in our view, suggest any impropriety in the transaction at issue here. *Vanston* disallowed on equitable grounds a claim for interest on unpaid interest, based on a pre-solvency contract, because the delay in interest payments was occasioned by a court order entered equally for the benefit and to the detriment of all creditors. Here, on the other hand, it was FRB's release of its lien and its agreement to forbear from collection of the debt for three years—an agreement entered into after insolvency so that the receivership estate would receive a $125 million premium (from a sale of the assets to European-American Bank) and the FDIC insurance fund would not be impaired—that resulted in the interest obligations in question. *Vanston* does not go to such a post-insolvency agreement, where there has been performance by the forbearing party and approval by the district court in accordance with the banking statute.

Under *Ticonic National Bank, supra,* the collateral held by FRB would not have become a part of the receivership estate until FRB's claim for principal and interest was fully satisfied. 303 U.S. at 412. In light of this decision, it was not inequitable for the FDIC to accept a plan for the repayment of FRB's indebtedness that included payments of post-insolvency interest. FRB's lien, prior to its release, exceeded the amount of the principal and interest owed under the later agreement with the FDIC. Absent such an agreement, FRB could have taken possession of the $2.2 billion worth of assets securing its loans—preventing the purchase and assumption by European-American and the resulting premium benefiting FNB—or demanded under *Ticonic* post-insolvency interest if such a

foreclosure were somehow delayed. A third possible outcome was a purchase and assumption financed by the FDIC itself and resulting in immediate payment to FRB. But this arrangement would concededly have required interest payments to FDIC during the course of liquidation. Based on FRB's existing rights and the options available to the FDIC at the time, we cannot say that it was inequitable to require the FNB estate to make interest payments at the rate of 8.5% compounded annually for the three years of forbearance, but with some payments deferred for the three years (until the principal was fully repaid) and the rest deferred even longer—to this day.

Nor, leaving aside the equities in this particular case, does *Vanston* establish any *per se* rule against interest on interest. It does establish that in a bankruptcy or reorganization proceeding when the court enjoins payment of interest, creditors cannot demand a penalty for nonpayment despite the sufficiency of their collateral. But it certainly does not bar under all circumstances a post-insolvency agreement with a secured creditor, offering the benefits of deferral of repayment to the debtor, even if the agreement includes a provision for compound interest.[4] And none of the Second Circuit cases cited by the Trustee of FNYC extends *Vanston* to this kind of case. In *In re Realty Associates Securities Corp.*, 163 F.2d 387 (2d Cir.), *cert. denied*, 332 U.S. 836 (1947), the court simply enforced interest provisions of the bond

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4 We note that, in a reorganization proceeding, the debtor can obtain the benefits of deferral of repayment without resort to such an agreement through the operation of 11 U.S.C. § 513 (1976), which authorizes the court to stay mortgage foreclosures or actions to enforce liens on the debtor's property.

indenture refusing to alter them by substituting a judgment return of interest or compound interest. In *Eddy v. Prudence Bonds Corp.*, 165 F.2d 157 (2d Cir. 1947), *cert. denied,* 333 U.S. 845 (1948), the court held that even in a corporate reorganization, where the test is whether the plan is "fair and equitable," a secured and senior series of bonds was entitled to priority as to equal principal and interest until payment, even though that would exhaust the collateral available for a junior series of bondholders. The court followed *Ticonic National Bank, supra,* pointing out that the reorganization provisions of the Bankruptcy Act then in effect

> did permit the plan to "deal with" the claims of secured creditors by giving them new interests in the corporate property instead of paying them in cash; but it did not affect their right to have the substituted interests computed upon the basis of the "value" of the interests—the liens—cancelled. Since the liens included interest to the date of payment, the substitute, to be lawful at all, had to include interest to the same date. Indeed . . . the Supreme Court recognized as much in its discussion in Vanston Bondholders Protective Committee v. Green.

165 F.2d at 160 (footnotes omitted).

In *Empire Trust Co. v. Equitable Office Bldg. Corp.*, 167 F.2d 346 (2d Cir. 1948), the court merely held that indenture provisions for the payment of interest on interest were invalid under New York law. And *Ruskin v. Griffiths,* 269 F.2d 827 (2d Cir. 1959), *cert. denied,* 361 U.S. 947 (1960), enforced a contract providing for a post-default increase in interest, even assuming that this was the equivalent of interest on interest, *id.* at

830, because the estate was solvent. *In re Kingsboro Mortgage Corp.,* 514 F.2d 400 (2d Cir. 1975) (per curiam), was a Chapter XI proceeding and therefore concerned only with unsecured creditors. 11 U.S.C. § 706(1) (1976). Finally, in *In re Continental Vending Machine Corp.,* 517 F.2d 997 (2d Cir. 1975), *cert. denied,* 424 U.S. 913 (1976), determined that, in a reorganization proceeding involving a parent corporation and its subsidiary, it was "fair and equitable" to pool assets and liabilities for purposes of dealing with unsecured claims while not doing so for purposes of dealing with secured claims.

In *Vanston,* the court was concerned about the effect on the welfare of subordinate creditors of a court order staying payments of interest to a secured creditor. If that stay had resulted in the payment of interest on interest, then the court's order would have led to a continued deterioration in the position of subordinate creditors from the date of the stay until the date of payment to the secured creditor. Here, however, the delay in repayment of the secured creditor was agreed to in part to allow a purchase and assumption by European-American and in part to allow orderly liquidation of remaining assets. This arrangement did not result in a deterioration in the position of appellants as subordinate creditors from the date of insolvency onward. In sum, *Vanston*'s "rule" against interest on interest has no application in this context.[5]

Judgment affirmed.

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5 We also agree with the district court's comments on the nature of these interest provisions:

> The formula agreed upon to arrive at the "interest rate differential" or "recoupment provision" is not a provision for compound interest within the proper definition of the term. That

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the agreement used the words "compounded annually" to calculate the amount of a differential to be paid as interest is not determinative. Other features of the recoupment provision—the fact that the total amount due was to be fixed only after three years, that no further interest accumulated on the differential although the date of payment thereof was and remains today in the uncertain and distant future—remove it wholly from the ambit of agreements to compound interest on interest which have been disfavored by some courts.

475 F. Supp. at 1070-71. Although a compounding formula was used to calculate contingent interest owed by FNB, this amount was essentially a single lump sum, dependent only on the rate of repayment of the principal over three years. This sum was limited from the beginning by the three-year period used. Depending on when one assumes that this contingent interest will ultimately be paid to FRB, one can calculate the effective interest actually charged. *See id.* at 1067-68.

APPENDIX B

District Court Opinion on Motion to Dismiss

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

No. 77 Civ. 4896(MP)

October 6, 1978

SOL NEIL CORBIN, as Trustee in Bankruptcy of Franklin New York Corporation,

Plaintiff,

v.

FEDERAL RESERVE BANK OF NEW YORK, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, in its Corporate Capacity and as Receiver of Franklin National Bank,

Defendants.

Trustee in bankruptcy of parent of insolvent national bank sued Federal Deposit Insurance Corporation and Federal Reserve Bank of New York and Board of Governors of Federal Reserve System on ground that interest provisions of agreement by which FDIC, in its corporate capacity, assumed that bank's indebtedness to Federal Reserve Bank were inequitable and unjust to creditors and shareholders of insolvent bank. The District Court, Pollack, J., held that: (1) the claim was not one for money damages and consequently was not barred by exclusive remedy or limitations provisions of Federal Tort Claims Act; (2) trustee had standing to complain of breach of

duty by FDIC as receiver, and (3) Board of Governors of Federal Reserve System was not indispensable party where trustee sought no relief against Board, trustee could obtain all relief sought by a declaration against FDIC and Federal Reserve Bank that interest provisions were invalid and such relief would not affect Board's operations or functions.

Order accordingly.

BARRETT, SMITH, SCHAPIRO, SIMON & ARMSTRONG, New York City, for plaintiff, by Michael O. Finkelstein, Joel M. Gross, New York City, of counsel.

CAHILL, GORDON & REINDEL, New York City, for defendant Federal Reserve Bank of New York, by William E. Hegarty, Allen S. Joslyn, Patricia A. Pickrel, New York City, of counsel.

ROBERT B. FISKE, JR., U.S. Attorney, S.D.N.Y., New York City, for defendant Board of Governors of Federal Reserve System, by Richard J. Weisberg, Assistant U.S. Attorney, New York City.

CASEY, LANE & MITTENDORF, New York City, for defendant Federal Deposit Insurance Corporation, by William E. Kelly, Christopher R. Belmonte, New York City, of counsel.

OPINION

POLLACK, *District Judge.*

This action arises from the events surrounding the insolvency of the Franklin National Bank ("FNB") in Octo-

ber 1974. Plaintiff is the Trustee in Bankruptcy ("Trustee") of the Franklin New York Corporation ("Franklin New York"), the parent holding company of FNB, and seeks recovery from defendants Federal Deposit Insurance Corporation ("FDIC") and the Federal Reserve Bank of New York ("FRB—NY") of allegedly excessive amounts of interest paid to FRB—NY by FDIC in its capacity as Receiver of the insolvent FNB. Defendant Board of Governors of the Federal Reserve System has been joined as an indispensable party. All defendants now move to dismiss the complaint for lack of federal subject matter jurisdiction and for failure to state a claim upon which relief may be granted.

Beginning in May 1974, FNB disclosed massive foreign exchange losses, and the resulting withdrawal of credit and deposits threatened to close the bank. FRB—NY began making daily loans to FNB, in increasing amounts which reached $1.723 billion on October 8, 1974. FRB—NY advanced the funds in its role as lender of last resort under the Federal Reserve Act, 12 U.S.C. § 221 *et seq.* The advances were secured by FNB assets, as required by 12 U.S.C. § 347b. The last note executed by FNB bore interest of 10% per annum to the date of maturity, October 8, 1974, in accordance with Regulation A of the Board of Governors of the Federal Reserve System ("Board"). 12 C.F.R. § 201.2(e)(2) (1978). No provision was made in the note for interest after maturity.

From May through October, the Comptroller of the Currency, FRB—NY and FDIC sought a solution to the FNB crisis, which threatened to severly disrupt the banking industry and the national economy and represented a potential liability of FDIC for the approximately $750 million in insured deposits. However, FNB's indebtedness to

FRB—NY and FRB—NY's security interest proved to be obstacles to a takeover of FNB's business by another bank, as most banks approached by FDIC were unwilling to accept these liabilities.

On October 8, 1974, the Comptroller declared FNB insolvent pursuant to 12 U.S.C. § 191. FDIC was immediately appointed Receiver of FNB, pursuant to 12 U.S.C. § 1821(c). Upon its appointment, FDIC executed various agreements with European-American Bank & Trust Company ("EAB") and FRB—NY. Under the terms of the Purchase and Assumption Agreement, EAB purchased certain of FNB's assets, including its 104 offices which reopened on October 9 as EAB offices, and assumed certain of FNB's liabilities, including all deposit liabilities, about $1.5 billion. *See In Re Franklin National Bank,* 381 F. Supp. 1390, 1391-92 (E.D.N.Y. 1974). A premium of $125 million was obtained from EAB to the benefit of the receivership estate because the assets were assumed without an interruption in services at the former FNB offices.

FDIC, acting in its corporate capacity, agreed with FRB—NY, in consideration of FRB—NY's release of its security interest in FNB assets, to assume and pay FNB's $1.7 billion indebtedness to FRB—NY with interest. The Assumption Agreement provided for repayment of principal and simple interest of 7.52%, less certain liquidation expenses, in three years, subject to an adjustment of interest up to a maximum of 8.5% compounded annually depending upon the amount realized in liquidation.

FDIC-corporate further agreed to purchase from FDIC as Receiver FNB's remaining assets for purposes of liquidation, in accordance with the Agreement of Sale. That Agreement further provided that any liquidation proceeds

in excess of repayments of principal and interest to FRB—NY would be paid over to FDIC as receiver for ultimate distribution to FNB's creditors and shareholders.

The various agreements were approved by the late Judge Judd of the Eastern District of New York pursuant to 12 U.S.C. § 192. *In Re FNB, supra.*

The FDIC has repaid FRB—NY as specified, with the final payment of principal and simple 7.52% interest made on October 7, 1977. The liquidation of assets purchased by FDIC continues and thus it is not known whether the upward adjustments of interest due FRB—NY will ever be made. If the interest is payable at the maximum rate, the total will be approximately $293 million, which is alleged to exceed by $103 million the amount that would reasonably compensate FRB—NY for the use of its money for three years, and would consume substantially all of the remaining assets of the FNB receivership estate.

Franklin New York filed a petition in bankruptcy on October 16, 1974, and plaintiff was appointed Trustee in Bankruptcy. Notice of plaintiff's claim was given FDIC and FRB—NY by letter dated May 17, 1977. This action was commenced October 6, 1977, nearly three years after the declaration of insolvency and the execution of the agreements described above. Plaintiff Trustee purports to bring this action as a creditor of the FNB receivership estate, and derivatively on behalf of FDIC-Receiver.

The several motions before the Court are disposed of as follows:

1. The First Claim for relief asserts that the interest provisions of the Assumption Agreement are "inequitable and unjust" to the creditors and shareholders of FNB. The Second Claim for relief asserts that FDIC is a trustee

for those creditors and shareholders and had a fiduciary duty to administer the liquidation of FNB in the interests of all creditors and stockholders; and that its agreement to pay inequitable interest was a breach of its fiduciary duty.

For purposes of its motion to dismiss these claims, FDIC assumed that it had and breached a duty to the plaintiff. Consequently whether there is such a duty and whether it was breached are questions which are not before the Court at this time. The statutes do give FDIC *in its corporate capacity* the discretion to set the terms and conditions of a purchase of assets from itself as a Receiver (12 U.S.C. §§ 1823(d) and (e))—but they do not give unlimited discretion to a Receiver to fix the terms and conditions of a sale of receivership assets. As to the Receiver, the fairness of the terms to which it agrees are not beyond the scope of traditional judicial review.

Consequently, under the assumptions noted above, the motions of FDIC and FRB—NY to dismiss the First and Second Claims are denied for the present, and an evidentiary hearing on the issue of fairness of the interest terms must be had.

In so holding the Court rules that plaintiff's claim is not for money damages[1] and consequently is not barred by the exclusive remedy or limitations provisions of the FTCA;[2] that the broad "sue and be sued" clause in the

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[1] The Court reserves the question whether to the extent plaintiff seeks to recover a part of the 7.52% simple interest already paid to FRB—NY the claim is one for money damages, litigation of which is barred by the FTCA. That issue may be raised by affirmative defense for later resolution.

[2] Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2401(b), 2675(a), 2679(a).

Federal Deposit Insurance Act[3] has waived FDIC's sovereign immunity with respect to this suit to enforce FDIC's fiduciary duty;[4] and that plaintiff has standing to complain of a breach of duty by FDIC as Receiver.[5]

2. The Third and Fourth Claims challenge the Assumption Agreement made by FDIC and FRB—NY as violative of the maximum term and the floating interest rate requirements of the Federal Reserve Act and Regulations of the Board of Governors and FRB—NY.[6] Those requirements do not support those claims since they apply only to advances by FRB to member banks and do not serve to limit the powers of FRB to work out a default on an advance when a member bank becomes insolvent.

The Third and Fourth Claims in the complaint are accordingly dismissed.

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[3] 12 U.S.C. § 1819.

[4] Plaintiff's claim is not a tort claim within the meaning of the FTCA. *Cf. Woodbury* v. *United States,* 192 F.Supp. 924, 937-38 (D.Or.1961). (breach of fiduciary duty arising out of contract not a tort), *aff'd on other grounds,* 313 F.2d 291, 294 (9th Cir. 1963) (indicating disagreement with district court). Therefore, plaintiff's reliance on the "sue and be sued" clause of § 1819 is not an improper attempt to avoid the requirements of the FTCA. *See, e.g., Edelman* v. *Federal Housing Administration,* 251 F. Supp. 715 (E.D.N.Y.1966), *aff'd,* 382 F.2d 594 (2d Cir. 1967).

[5] Plaintiff has alleged an injury in fact, and his interest in the proper administration of the FNB estate is among those protected by FDIC's obligations as a fiduciary. *See, e.g., Sierra Club* v. *Morton,* 405 U.S. 727, 733, 92 S.Ct. 1361, 31 L.Ed.2d 636 (1972).

[6] 12 U.S.C. §§ 347, 347b; 12 C.F.R. § 201.3(e)(2) (1978); FRB—NY Op.Cir. No. 12, rev. eff. Feb. 4, 1971.
N.B. The area of the issue to be litigated is reasonably narrow and any discovery proceedings to be conducted herein should adhere to matter relevant to that narrow scope, namely, the fairness of the rates of interest provided in the Assumption Agreement.

3. Defendant Board of Governors of the Federal Reserve System has been joined as an indispensable party. Plaintiff has conceded that he seeks no relief against that defendant. The plaintiff could obtain all the relief he seeks by a declaration against FDIC and FRB—NY that the interest provisions of their agreement are invalid, if such a declaration were appropriate. Such relief will not affect the Board's operations or functions and there is no need to join the Board on the notion that a superior officer is indispensable to an action against a subordinate. *Williams* v. *Fanning,* 332 U.S. 490, 494, 68 S.Ct. 188, 92 L.Ed. 95 (1947). *See* 3A J. Moore, *Fed. Prac.* ¶ 19.16[2] (2d ed. 1974). *Cf. Raichle* v. *Federal Reserve Bank of New York,* 34 F.2d 910, 916 (2d Cir. 1929).

The defendant Board of Governors of the Federal Reserve System is dismissed from this suit.

4. The motion to transfer this suit to the Eastern District of New York is denied.

So Ordered.

APPENDIX C

District Court Opinion Dismissing Complaint After Trial

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT NEW YORK

No. 77 Civ. 4896 (MP)

Sept. 4, 1979

SOL NEIL CORBIN, as Trustee in Bankruptcy of Franklin New York Corporation,

Plaintiff,

and

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, *et al.*,

Plaintiffs-Intervenors,

v.

FEDERAL RESERVE BANK OF NEW YORK, Federal Deposit Insurance Corporation, in its corporate capacity and as Receiver of Franklin National Bank,

Defendants.

The trustee in bankruptcy of the parent of a large insolvent bank brought suit against the Federal Reserve Bank of New York and the Federal Deposit Insurance Corporation, in its corporate capacity and as receiver of the bank, seeking a reduction in the interest rate payable to the Federal Reserve Bank of New York on its agreement to forbear for three years the collection of a past-due $1.7 billion secured indebtedness of the bank. The District Court, Pollack, J., held that the questioned interest rate

arrangements were part of a global negotiation of a series of interdependent and complex matters that were negotiated at arm's length, were agreed to in the exercise of sound judgment by the receiver and the FDIC (corporate), were fair to the receivership estate and were not a breach of fiduciary duty, and that FRB—NY did not act unfairly or overreach the receiver.

Complaint dismissed.

BARRETT, SMITH, SCHAPIRO, SIMON & ARMSTRONG, New York City, for plaintiff Sol Neil Corbin, as Trustee in Bankruptcy of Franklin New York Corp.

CAHILL, GORDON & REINDEL, New York City, for defendant Federal Reserve Bank of New York.

DEBEVOISE, PLIMPTON, LYONS & GATES, New York City, for plaintiffs-intervenors.

CASEY, LANE & MITTENDORF, New York City, for defendant Federal Deposit Ins. Corp.

DECISION AND OPINION

POLLACK, *District Judge.*

This suit, presented at a Bench trial, seeks a reduction in the interest payable to the defendant Federal Reserve Bank of New York (FRB—NY) on its agreement to forbear for three years the collection of a past due $1.7 billion secured indebtedness of Franklin National Bank. The agreement was made with defendant Federal Deposit Insurance Corporation (FDIC) on the latter's purchase of

assets from the Receiver of Franklin National Bank (FNB) and FDIC's assumption as primary obligor of the FNB indebtedness. The forbearance agreement and assumption were made with FDIC in its corporate capacity. FNB had been declared insolvent at the close of business on October 8, 1974 and FDIC was named as its Receiver by the Comptroller of the Currency. Pursuant to statutory authorization as the Receiver, FDIC sold the assets of the closed bank here involved to FDIC in its corporate capacity for purposes of liquidation.[1]

The plaintiff is the Trustee in Bankruptcy of FNB's parent, viz., Franklin New York Corporation, which owns all the outstanding stock of FNB, except directors' qualifying shares, and also holds a claim against FNB as a creditor thereof for $136,000. On October 16, 1974 the parent holding company filed a petition in bankruptcy and plaintiff was appointed as Trustee in Bankruptcy. He purports to bring this suit as a creditor of the FNB receivership estate and derivatively on behalf of FDIC—Receiver. He asserts that FDIC, as Receiver, owed a fiduciary duty to the creditors and stockholders of FNB which it breached by permitting FDIC in its corporate capacity to agree to the interest rate provisions of the assumption agreement; that those rates were unfair and that FDIC as Receiver in permitting the same did not act in respect thereto as a prudent fiduciary with proper regard for the interests of the creditors and shareholders of FNB.

This action was commenced on October 6, 1977, nearly three years after the declaration of FNB's insolvency and

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[1] Pre-trial motions in this case resulted in an Opinion filed herein on October 6, 1978 to which reference is made. 458 F.Supp. 143. Familiarity therewith will be assumed to avoid some repetition.

the substantial execution of the transactions referred to above. Shortly prior to the trial, holders of FNB's Subordinated Capital Debentures which are subordinate to the principal of and interest upon all liabilities of FNB, were granted leave to intervene on the side of the plaintiff and to participate in the trial, with certain limitations.

The defendants have contested the Court's jurisdiction and at all events have denied liability on the merits.

It appears by the preponderance of the credible evidence and the circumstances and the reasonable inferences to be drawn therefrom that the interest rate arrangements which have been questioned were part of a global negotiation of a series of interdependent and complex matters that were negotiated at arm's length, were agreed to in the exercise of sound judgment by the Receiver and FDIC (corporate), were fair to the receivership estate and were not a breach of fiduciary duty and that FRB—NY did not act unfairly or overreach the Receiver. Accordingly, the complaint must fail.

I.

The Background

In 1974, FNB was the twentieth largest bank in the United States. It had 104 banking offices. Early in May, 1974, FNB publicly announced massive losses in foreign exchange transactions during the first quarter of 1974. These disclosures caused a withdrawal of credit and deposits which threatened to close FNB and to severely disrupt the banking industry and the national economy. FNB was forced to turn to the Federal Reserve discount window for emergency borrowings which were available to member

banks. A few days before the announcement, FRB—NY offered FNB discount window assistance on a daily basis as needed "within the limits of the collateral that can be supplied."

Commencing on May 8, 1974, with a loan of $135 million, FRB—NY began to make such emergency window one-day secured loans to FNB in amounts which increased sharply after May 13 and continued to mount until October 7, 1974. These window loans were made to avoid a liquidity crisis at FNB and the threat of a bank run, panic in the banking industry and a disruption of the national economy. The immediate effect of these window loans was to permit FNB to repay its large daily and short-term borrowings of unsecured federal funds from other banks that were not renewed after May 13. By law, the advances by FRB—NY to FNB had to be and were secured by FNB assets.[2]

To the extent that FNB furnished collateral "eligible" for purchase or discount by the Reserve Banks, the window loans made by FRB—NY thereon carried interest at the rate of 8% per annum;[3] the balance of the window loans, representing the bulk of FNB's borrowings, were secured by collateral acceptable as "satisfactory" by the Reserve Banks and these by law carried interest at a rate not less than one-half of one per-cent per annum higher than the highest discount rate in effect at the Reserve Bank making the loan (here made at 8½%).[4]

Beginning on September 27, 1974, the interest rate on FNB's emergency window one-day loans became 10% per

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[2] Sec. 10(b) Federal Reserve Act; 12 U.S.C. § 347b.

[3] Sec. 13, id.; 12 U.S.C. § 347.

[4] Sec. 10(b), id.; 12 U.S.C. § 347b.

annum pursuant to a newly promulgated regulation of the Board of Governors of the Federal Reserve System.[5]

On October 8, 1974, FNB's indebtedness to FRB—NY amounted to $1,723,472,054 (the "Indebtedness" hereafter) which bore contract interest at the then 10% rate and was secured to the satisfaction of FRB—NY by collateral of value in a face amount in excess of $2.28 billion. The Indebtedness as incurred was evidenced by a series of one-day FNB promissory notes maturing the next day. During the period of the loans the interest accruing on each one-day note made by FNB was added to the principal amount of the following day's note.

II.

On October 8, 1974, at 3:00 PM, the Comptroller of the Currency declared FNB insolvent pursuant to 12 U.S.C. § 191 and, as required by 12 U.S.C. § 1821(c), promptly appointed FDIC as FNB's Receiver. FNB's assets were then thought to be worth about $4-billion. Prior thereto, at the instance of the Comptroller of the Currency, beginning in July 1974, FDIC had undertaken contingency planning to work out the solution for FNB and had conducted discussions with banking interests concerning the possibility of a take-over of FNB's assets and liabilities or at least a part of them by a purchase and assumption transaction. Coincident therewith, FDIC sought to evolve a three to five-year repayment program for any remaining Indebtedness to FRB—NY pursuant to which FDIC in its corporate capacity would assume that remaining Indebtedness and have time to pay it off from the liquidation of FNB's assets.

[5] 12 C.F.R. § 201.2(e)(2) (1978).

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FRB—NY is not ordinarily a long-term lender; its window loans are normally of short duration; it functions to represent the public as a lender of last resort.[6] Federal Reserve Act, 12 U.S.C. § 221 *et seq.* However, the efforts of FDIC to reach a solution for FNB's predicament bore fruit in the following agreements of October 8, 1974 which were made after FNB was declared insolvent and placed in receivership.

1. European-American Bank & Trust Company ("EAB"), as successful bidder, agreed pursuant to a "Purchase and Assumption Agreement" to purchase $1.54 billion of FNB assets from FDIC as Receiver including the 104 branch offices of FNB, and to pay a $125 million premium therefor. The banking offices would thereby be enabled to open the next day for business without interruption. EAB assumed $750 million of insured deposits and over $900 million of uninsured deposits and other general liabilities. An express condition of this agreement was the release by FRB—NY of its lien upon the assets of FNB.

2. FDIC as Receiver, sold pursuant to an "Agreement of Sale," all of the remaining assets of FNB not acquired by EAB to FDIC (corporate) for liquidation thereof, the proceeds of those assets to be applied to pay the principal and interest due on the Indebtedness to FRB—NY, the costs of liquidation, any loss which FDIC might sustain on a Capital Note which FDIC (corporate) agreed to purchase from EAB to facilitate EAB's transaction with the Re-

[6] In keeping therewith, the surplus revenues of the Federal Reserve are turned over to the Treasury of the United States each year, after providing a fixed return of 6% to its stockholders.

ceiver, and a return of 6½% per annum on out-of-pocket funds advanced by FDIC (corporate) for the foregoing purposes. Any excess remaining from the liquidation after the proceeds were so applied was to be remitted to the Receiver as contingent additional consideration for the sale to FDIC (corporate) of the remaining assets.

3. FDIC (corporate) and FRB—NY entered into an "Agreement of Assumption of Indebtedness" by which FRB—NY agreed:

> (1) to forbear for a period of three years until the Final Payment Date from enforcing any of its rights relating to the Indebtedness;
>
> (2) to modify the interest rate payable on the FRB Indebtedness by reducing the rate to 7.52% simple interest per annum on the unpaid principal amount thereof, payable on the Final Payment Date, less an "adjustment" of up to $15 million for expenses in liquidating the remaining assets, and by the payment to FRB—NY of an additional amount of interest in the contingency that the liquidation should provide funds therefor, to increase the amount of the total interest to a rate of 8½% compounded annually over the three year forbearance. The contingent obligation was not to bear interest for non-payment thereof at the Final Payment Date.
>
> (3) to release its lien on and security interest in such collateral as was purchased by EAB from FDIC as Receiver pursuant to the contemporaneously executed Purchase and Assumption Agreement with EAB;

(4) to release its lien and security interest in the remaining collateral as it was transferred or liquidated by FDIC against payment of the proceeds in reduction of the Indebtedness and payment of the obligations assumed by FDIC absolutely or contingently; and

(5) to release the Receiver unconditionally from its primary liability with respect to the Indebtedness, and to hold it only secondarily liable if FDIC (corporate) did not pay the same.

FDIC (corporate) agreed:

(a) to liquidate the remaining assets of FNB as agent for the FRB and to remit the proceeds to FRB—NY in payment on account of the principal of the Indebtedness;

(b) to assume the Indebtedness as primary obligor and to pay on October 7, 1977 (the Final Payment Date) any balance of the Indebtedness then outstanding together with simple interest over the three-year period calculated at the rate of 7.52% per annum on the principal amounts outstanding less the actual out-of-pocket expenses of FDIC incurred in liquidating the remaining assets but not to exceed $15. million.

(c) to pay FRB—NY, if the proceeds from liquidation of the remaining assets exceeded the sum of the Indebtedness, the interest mentioned above in subdivision "(b)" and the costs of liquidation, as additional interest an amount computed on the outstanding Indebtedness at the rate of 8.5% per annum (compounded annually) less the interest computed at the fixed rate of 7.52%.

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Over the period of the forbearance, FNB's former assets were liquidated and payments on account of the principal of the Indebtedness were made to FRB—NY. At the date of maturity of the loan, October 7, 1977, FDIC (corporate) paid over $607 million to FRB—NY from its insurance trust funds to satisfy the remainder of the Indebtedness with interest at the fixed rate of 7.52%. Some $200. million of the sum so advanced by FDIC plus interest remains presently unpaid. The liquidation of the remaining assets has been continuing; self-evidently no payment of the contingent interest agreed upon has as yet been made to FRB—NY.

The Agreement of Assumption of Indebtedness between FRB—NY and FDIC (corporate) was approved by the Board of Governors of the Federal Reserve System. In addition, the sales of the assets to EAB and of the remaining assets to the FDIC, by the Receiver, as well as the sale of the FNB trust business to Bradford Trust Company were presented in a petition for approval as required by 12 U.S.C. § 192 in an ex parte proceeding to the United States District Court for the Eastern District of New York and were approved on October 8, 1974 by the late Judge Orrin Judd who authorized and directed FDIC as Receiver to execute all documents necessary or convenient to carry out their terms and provisions.

III.

As already indicated the Receiver sold the remainder of FNB's assets to FDIC (corporate) on its agreement to liquidate those assets and to satisfy therefrom the principal liabilities of FNB. The price to be paid was the assumption by FDIC (corporate) of FNB's liabilities to FRB-NY and the purchase by FDIC (corporate) of a Capital Note from

EAB. As dditional contingent compensation FDIC (corporate) agreed to turn over to the Receiver any proceeds of the liquidation remaining after satisfying the obligations described in the Agreement of Sale. Thus, the Receiver had a contingent interest in the scope of the obligations that FDIC (corporate) assumed—the greater these were, the smaller would be the chance of additional compensation to the receivership estate for the sale.

FDIC had FNB's deposits. It had a corporate and governmental interest in seeing to it that the depositors' claims were satisfied at the minimum cost to its insurance trust funds. The opportunity to be relieved of paying depositors was presented in a sale of those liabilities to EAB. As release of the lien of the Reserve Bank was prerequisite to a sale to EAB, FDIC (corporate) had an impetus to pay whatever terms were demanded by FRB—NY for the forbearance, while as Receiver its interest was to effect the Reserve Bank's forbearance at the cheapest rate of interest obtainable.

It is because of the conflicting interests so faced that plaintiff attacks the monetary interest terms of the assumption agreement as excessive and otherwise improper.

The sale to FDIC (corporate) by the Receiver was authorized by federal statute. 12 U.S.C. § 1823. On the basis of the statute defendants argue that a Court may not reach into the transactions to reduce the interest aspect of the forbearance assumed by FDIC (corporate). However, the Court has heretofore held that the fairness of the transactions made by the Receiver, of which the interest arrangement is only a part is nonetheless reviewable because of the dual interests which FDIC served, as Receiver of the insolvent estate and corporate-wise as insurer of the bank's deposits.

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IV.

Interest is the price of the use of money loaned or of forbearance, according to a fixed ratio. The forbearance agreed to by FRB—NY with FDIC in 1974 was *sui generis* —no such forbearance or any loan of a similar size had been effected previously in economic history. Perforce there is neither a standard or going rate available for direct comparison with the interest rate challenged here. Plaintiff contends that FRB—NY was entitled only to post-insolvency simple interest up to October 7, 1977 at a lower rate than agreed upon and only to the extent payment of such interest would achieve a balance of equities among creditors of FNB, and between creditors of FNB and the FNB receivership estate. Plaintiff is content to accept the benefit of the purchase and assumption transaction. He attacks only the consideration due the Reserve Bank for its release of its rights as a secured creditor and its three year forbearance and the release of its liens which made the transaction possible.

The rate of interest on the forbearance was a major subject of discussion and negotiation for several weeks and remained fluid right up to the moment of the final form of the agreements. Drafts and counterdrafts were exchanged in the negotiation and objections were voiced on each side resulting in changes and modifications as the drafts continued to flow. Richard A. Debs, then Vice-President and Chief Administrative Officer of FRB—NY and now with Morgan, Stanley & Company, gave the following testimony:

> This was a unique loan. But basically, we looked to the market rates prevailing at that time . . . there was a lot of discussion about what a fair rate should be for

> the Franklin loan . . . this was going to run out to several years. . . . They [FDIC] were negotiating rather hard, as they should have, in terms of their own interest and their own funds and so forth to keep the rate as low as possible from their point of view.
>
> We, on the other hand, had an obligation as Federal Reserve officers with public assets involved and basically ultimately taxpayers money involved, to make sure that we were not in any way giving away taxpayers money.
>
> And the benchmarks we looked to were market rates.
>
> * * * * * *
>
> [O]ur ultimate aim in this specific transaction was to aim at a rate that was a defensible, appropriate rate in terms of all the benchmarks we had to look to. We did not have a duty in any way to insure that the shareholders of Franklin received any benefits.

Initially, FDIC was thinking of an interest rate consistent with its own portfolio rate of about 6¼% which was lower than the open market rate, albeit the new money at FDIC was being invested at current market rates in the high 7 percents and about equal to or in excess of the open market rate which was a floating rate on a day to day basis and not a specified figure.

Factored into the rate question was the fact that FRB—NY was not going to receive its money immediately.

Whether the rate was to be a floating one or a fixed rate was very much a topic of the negotiations. There was no consensus as to the level to which the rates of interest would decline or the length of time during which they would re-

main at a lower level. Many economists and analysts believed that long term rates would remain high as long as inflation remained above 5%. The future course of long-term interest rates was highly unpredictable. It was foreseen that interest rates could fluctuate rather widely during the projected three to five year repayment period. The ultimate consensus of the FDIC staff was to attempt to reach agreement on a fixed rate rather than a floating rate.

Interest rates in the money markets rose steadily during the first eight months of 1974, reaching historic high levels for both long and short-term obligations in August. In the latter part of August rates began to sag. The discussions which led to the transactions of October 8, 1974 took place between July and October. There was a wide difference of opinion on the future course of the economy, inflation, recession, the securities markets and the money markets. Many economists and analysts expected further declines in interest rates. On the other hand, there were those who were reasonably skeptical and believed that much uncertainty lay ahead, and that while yields were expected to fall irregularly the decline would be moderate going into 1975. The roller coaster of interest rates depended on many imponderables and forecasts gave no assurance that for the long term the economy was not facing another round of double digit rates of interest as well as of inflation. A floating rate could as well float upward as downward over a period of years and there was no predictable mean on which to rely.[7]

The key United States money market interest rates included the following short and long term rates or yields:

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[7] The current period bears a striking parallel to the 1974 money market picture, even to the months of the year in which the changes were occurring.

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Federal Reserve Funds rate: The interest rate on loans of Reserve Bank funds traded among commercial banks for overnight use in amounts of $1 million or more.

Discount rate: The interest charged by the Reserve Bank on short term loans to member commercial banks.

System Open Market Account rate: The average interest return on the FRB—NY portfolio of government and agency securities (referred to hereafter as the "SOMA" rate).

Prime rate: The interest charged by large United States money center commercial banks to their best business borrowers.

During the period of the negotiations these interest rates were approximately as follows:[8]

Rate (%)	May	June	July	August	Sept.	Oct. 8
Federal Funds[9]	11.29	11.45	12.60	11.84	11.12	11.04
Discount on "eligible" collateral	8.	8.	8.	8.	10.[10]	10.
Discount on "satisfactory" collateral	8–½–9	8–½–9	8–½–9	8–½–9	10.[10]	10.

[8] The stated rates are all based on payment of interest more frequently than annually. Their compound annual equivalents are higher if to be compared with the 8½% compounded annually in the Assumption Agreement.

[9] Federal Funds rate peaked in July 1974 at 13.55%, went down for a year, levelled off and started an upward climb in July 1977. By the end of June 1978 the rate was 7.53% and climbed steadily thereafter. At the end of December 1978 Federal Funds were again traded at a double digit interest rate. Currently, Prime and Discount rates are also in double digit percents.

[10] On September 27, 1974 FRB—NY established a discount rate of 10 percent per annum on advances to member banks for prolonged periods and in significant amounts. *See* text at note 5.

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Rate (%)	May	June	July	August	Sept.	Oct. 8
SOMA	7.06	7.19	7.22	7.23	7.61	7.52
Prime	11.50	11.75	12.00	—	—	11.75
3-5 Yr. U. S. Treasury issues				8.55	8.61	8.07
3 Yr. U. S. Agency Bds.	8.30	8.29	8.69	9.05	9.36	8.49

The interest aspect of the October 8, 1974 transactions jelled at agreement to modify the latest prevailing FNB contract rate of 10% to the SOMA rate (7.52%) as the fixed interest less $15,000,000 liquidation expenses, such interest to be paid at maturity[11] rather than currently; and when and if the proceeds of liquidation ultimately permitted, to pay therefrom the $15 million expenses and an additional amount to bring the fixed interest up to the area of the original FNB contract rate, i.e., an amount arrived at by accruing interest at the annually compounded rate of 8.5% over three years less the amount of the fixed interest paid at 7.52%.

The contingent addition to the interest obligation was designed to recoup the difference between the SOMA rate being discussed (approximately 7.5%) and the one-day note rates existing and payable by FNB in August 1974 (8% if loan was secured by "eligible" and 8½% if secured by "satisfactory" collateral). This was referred to variously as the "interest rate differential" or as a "recoupment" pro-

[11] It was estimated in 1974 that this deferral of payment of interest until the end of three years would benefit the receivership state by approximately $26 million. The actual benefit has been $35 million.

vision. In the course of the continuing negotiation of terms on September 9 FRB—NY inserted the compounding feature for the calculation of the contingent recoupment in its draft of agreement submitted to FDIC. On September 10, 1974 FDIC's representatives agreed with the principle that FRB—NY should recoup the difference between the interest rate paid by FDIC and the rate previously paid by FNB before payments to creditors or shareholders of FNB, but the rate of interest to be used in determining the amount of such recoupment continued to be a subject of intense bargaining and compromises up through at least September 26. There seems to have been some discussion of FRB—NY wanting the 10 percent rate which became effective on September 27. Ultimately the 8½% rate calculated as proposed on September 9 for the additional interest was the rate agreed upon as approximating a market rate, the additional amount to be entirely contingent upon actual collections from the assets of FNB.

The effective annual yield of the fixed portion of interest under the Agreement of Assumption of Indebtedness at 7.52% nominally was 6.485% and assuming as the parties seem to do that it takes another six years to liquidate assets sufficient to cover the contingent aspect of the interest, the effective yield to FRB—NY on the total of the interest obligation payable to it is 7.65% if paid in 1985, 7.74% if paid in 1984, 7.83% if paid in 1983, 7.92% if paid in 1982 and 8.03% if paid in 1981. Meanwhile, the FNB receivership estate has obtained as benefits of the arrangement the $125 million premium from EAB on the assets sold to it, a sale made possible by lifting of FRB's security interest in those assets and to date another $341 million in income on collateral released by FRB—NY.

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V.

It is conceded by the plaintiff that FRB—NY is entitled to be fairly compensated for the use of its money represented by the Indebtedness; that the appropriateness or fairness of the interest rates which FNB's estate might ultimately bear for the three year accommodation, must be determined in light of the circumstances existing and reasonably to be perceived *at the time* that the Assumption Agreement was made. No charge is made there of any bad faith or fraud on anyone's part in the negotiations or Agreements.

The question in this case as indicated is whether FDIC improperly burdened the potential results of the asset liquidation and thereby reduced the contingent additional consideration for the sale of the assets to FDIC (corporate).

At the threshold it must be observed that FNB or FDIC as Receiver of FNB, could not have borrowed the $1.7 billion necessary to repay the Indebtedness in the market on October 8, 1974 at any rate of interest. Loans made by the Federal Reserve are made for a public purpose, they are not intended to serve private interests; its loans are made only to banks; it is not in commercial business. Thus, setting of its rates of interest in transactions of the sort here involved is really a political or philosophical problem and not a financial problem. To have allowed FNB to go to immediate liquidation would have had tremendous repercussions; the entire banking system might have been destroyed.

The circumstances existing in which the rescue effort occurred included the onset of an economic recession,

political trouble at home, an important bank failure abroad, energy dislocations and the oil crisis from the quadrupling of oil prices and a generally unprecedented economic situation. The plan of the Receiver to arrange a forbearance by FRB—NY was an attempt to create as few waves as possible in the financial market and in a very difficult situation.

There was a paramount public interest here to be served; but this is not basis for an obligatory subsidy by the Federal Reserve to augment FNB's estate for the benefit of the subordinated debenture holders and stockholders of FNB.

Reserve Banks are operated for public service. The member banks as stockholders do not have or expect the attributes of control of financial interest ordinarily attached to stock ownership in corporations that are operated for profit. In case of the liquidation of any Reserve Bank, its surplus would be paid entirely to the United States. Its surplus income belongs to the United States and goes into the Treasury annually. Any lowering of interest charges for advances to a member bank or for its benefit is directly made at the expense of the general taxpayer.

The Federal Reserve Act was enacted to give the country an elastic currency, to provide facilities for discounting commercial paper and to improve supervision of banking. Its purposes do not include overriding of the public's interest by preferred or special or concerned treatment of holders of subordinated debentures and stock of insolvent banks. It has no obligation at the expense of the general taxpayer to subsidize money lenders to banks which become insolvent or their stock investors, or to supply term loans at below-market or noncommercial rates of interest, di-

rectly or indirectly or for the benefit of FDIC as Receiver of insolvent banks. Nor is it obliged to discount commercial paper at rates more favorable after insolvency than before insolvency of a member bank. It is the public interest that the Federal Reserve Bank must serve.

The primary purpose of FDIC is to insure the deposits of all banks entitled to insurance benefits under the Federal Deposit Insurance Act; to pay off depositors of insured banks; to act as receiver for all national banks placed in receivership and to prevent the continuance or development of unsafe and unsound banking practices.

FDIC is not obligated even if named as Receiver to apply its trust fund for the benefit of the interests of subordinate debenture and stock holders of insolvent banks or to furnish subsidies for them.

As receiver, FDIC is obliged to take custody and to marshal the assets and liquidate the affairs of an insolvent bank.

The notion that is unspoken here by plaintiff and the intervenors that FDIC was in some way obligated to supply its trust funds at interest rates lower than available from FRB—NY to ease or accomplish the liquidation of the FNB receivership estate, has no basis in fact or in law. Thus to suggest as an alternative that FDIC should have used $2 billion of its own money to mitigate the rate of interest charged by FRB—NY is a groundless suggestion. No receiver is bound to use its own funds to enhance a receivership estate. There was no financing other than the forbearance of FRB—NY which was reasonably available for the orderly liquidation of the receivership estate.

During 1974 FDIC invested its new funds at an average rate of 8.05% per annum albeit the average return on the

Corporation's portfolio of government securities was 6½% because many old loans were contained therein. Consequently as an aside, it appears that it could make no difference to the receivership estate whether the $1.723 billion was borrowed in effect from FRB—NY at an effective yield from 7.65% to 8.03% (depending upon when the contingent interest is completely paid), or loaned on the same conditions by FDIC at the same rates from its trust funds held for assurance of depositors' balances, as suggested by plaintiff.

The give and take of the negotiation of the Agreement of Assumption of Indebtedness in which the final provisions for fixed and contingent interest became an integral part included many permutations and combinations and compromises of a variety of complex matters. The choice made by the Receiver not to risk the rollercoaster of Reserve Bank discount rates, in a nervous economy, cannot be faulted as a breach of fiduciary duty of the Receiver by a hindsight wisdom developed after the storm had spent itself, long after the deal closed. The shelter of a fixed rate was a rational choice that the Receiver was privileged to make in administering the interests of the Estate. In 1974, a respectable body of opinion was against gambling on the future cost of money. The agreements were neither arbitrary nor capricious.

With the benefit of hindsight, plaintiff's experts freely opined that prudence dictated that the Receiver and FDIC should have obtained a floating rather than a fixed rate of interest obligation for the three-year forbearance by FRB—NY. Those experts conceded that a floating rate presented a risk. A floating rate can float up as well as

down; but plaintiff's expert found solace for this in the opinion that "if you were wrong under those circumstances you would be wrong in awfully good company." The same expert put his finger on an important consideration of the hindsight appraisals the Court received when he said: "You can't really sit back and do a laboratory study of this kind for those circumstances and say one's right and one's wrong."

The law provides that the Government is entitled to be adequately compensated for the use of its money. *See United States* v. *Ring Construction Co.*, 113 F.Supp. 217 (D.Minn.1953); *United States* v. *Hopkins*, 95 F.Supp. 14 (N.D.Ohio 1951); *United States* v. *American Metal Co.*, 86 F.Supp. 533 (D.N.J. 1949). In determining the fairness of interest rates, courts have looked to the rates set by contract between the parties, prevailing market rates and legal lending rates. *See Mid-Jersey National Bank* v. *Fidelity-Mortgage Investors*, 518 F.2d 640 (3d Cir. 1975); *In re Hartsdale Associates*, 452 F.Supp. 67 (S.D.N.Y. 1978); *Walter E. Heller & Co.* v. *Cox*, 343 F.Supp. 519 (S.D.N.Y. 1972), *aff'd mem. sub nom. Walter E. Heller & Co.* v. *Ocean Air Tradeways*, 486 F.2d 1398 (2d Cir.), *cert. denied*, 414 U.S. 827, 94 S.Ct. 46, 38 L.Ed.2d 61 (1973).

In light of these criteria, the interest rate charged by FRB—NY was more than fair to the receivership estate. The rate provided in the Assumption Agreement, even if the contingent amount is fully paid, afforded a yield below the relevant market rates, the contract rates of the FNB notes (8½%, later 10%), and the legal lending rate set by the New York Banking Board under N.Y.Gen.Oblig.Law § 5-501(1) (8½%). Under all the facts and circumstances, plaintiff's claim that the FRB—NY rate was unfair falls to

the ground. The plaintiff has failed to sustain a claim of unfairness with credible evidence.

Were New York law applicable to the choice of an appropriate rate, the FRB—NY would be entitled to post-insolvency interest at the legal, contract or market rate, and would not be limited to interest at the judgment rate. The Reserve Bank would have been entitled to foreclose on its security in an equitable proceeding under state law and the court would not be bound to apply the judgment rate but could in conformity with principles of equity award interest at higher market or contract rates. *See* N.Y. C.P.L.R. § 5001 (a).

VI.

The dual role of the FDIC in the transaction with FRB—NY was authorized by congressional mandate. 12 U.S.C. § 1823(e) (1976). Congress provided in that statute that "the Corporation [FDIC] may purchase any such assets" of a closed insured bank and that "the Corporation as receiver [of an insured bank] is authorized to contract for such sales." This statutory authority disposes of plaintiff's contentions under the rule against divided loyalty, *see, e.g., Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545 (1928). The FDIC did not place itself in irreconcilable conflict with the receivership estate by entering into a transaction expressly authorized by statute.

The contract to be reviewed involves two federal agencies acting pursuant to the comprehensive scheme for the regulation of National Banks and of our nation's monetary system. The rules of decision are to be sought first in the National Bank Act, 12 U.S.C. §§ 191-200, the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-1832, and in the case

law thereunder. *See United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 99 S.Ct. 1448, 59 L.Ed.2d 711 (1979); *D'Oench Duhme & Co.* v. *F.D.I.C.*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956 (1942). If federal law is silent in a particular circumstance, state law may be selected as the applicable federal rule where it would provide a rule of general applicability which would not frustrate a federal policy or program. *See United States* v. *Little Lake Misere Land Co.*, 412 U.S. 580, 93 S.Ct. 2389, 37 L.Ed.2d 187 (1973); *Clearfield Trust Co.* v. *United States*, 318 U.S. 363, 63 S.Ct. 573, 87 L.Ed. 838 (1943).

Under the law of National Bank receivership, a secured creditor of a National Bank is entitled to the interest on the principal obligation owing to it to the extent that its security is sufficient to cover both principal and interest, notwithstanding the insolvency of the Bank or the appointment of a Receiver for it. *See Ticonic National Bank* v. *Sprague*, 303 U.S. 406, 412-13, 58 S.Ct. 612, 82 L.Ed. 926 (1938). Any contrary doctrine to be found in cases arising under the Bankruptcy Act is irrelevant, as that Act expressly exempts National Banks from its bankruptcy and reorganization provisions. 11 U.S.C. §§ 22, 506 (1976); 11 U.S.C.A. § 109 (b) (1979) (effective October 1, 1979); *see* S.Rep. No. 95-989, 95th Cong., 2d Sess. 31 (1978), *reprinted in* [1978] *U.S. Code Cong. & Admin.News*, p. 5787.

Plaintiff's challenge to the contingent portion of the interest agreement as a form of illegal compounding of interest also lacks substance. The formula agreed upon to arrive at the "interest rate differential" or "recoupment provision" is not a provision for compound interest within the proper definition of the term. That the agreement used the words "compounded annually" to calculate the amount

of a differential to be paid as interest is not determinative. Other features of the recoupment provision—the fact that the total amount due was to be fixed only after three years, that no further interest accumulated on the differential although the date of payment thereof was and remains today in the uncertain and distant future—remove it wholly from the ambit of agreements to compound interest on interest which have been disfavored by some courts.

Even if the recoupment provision were to be deemed an agreement to pay compound interest, there is no general federal policy or rule of law against an agreement to pay compound interest on obligations incurred by National Banks or their receivers with a Federal Reserve Bank. In particular, the case relied on by plaintiff, *Vanston Bondholders Protective Committee* v. *Green,* 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946), does not establish any rule applicable herein. *Vanston's* disapproval in a reorganization proceeding of a pre-insolvency agreement to pay interest on unpaid interest is of no relevance to the instant review of the post-insolvency agreement made by the Receiver in the course of its obligations under the federal banking laws to wind up the affairs of an insolvent National Bank. At most, the equitable principles invoked in *Vanston* merely sanction the review of the agreement which has been conducted herein; they do not condemn compound interest in all circumstances and do not preclude this Court's finding that the agreement was fair and appropriate.

This Court also declines to invoke as the rule of decision herein the New York common law rule against interest on interest. That rule appears to be aberrant among the laws of the fifty states, *see* 6A A. Corbin, *Contracts* § 1508, at 702-03 & n.30 (1962), is subject to an exception for agree-

ments between merchants, *Young* v. *Hill,* 67 N.Y. 162, 171 (1876), and arose from concerns of public policy inapplicable to an agreement between two federal agencies, *see Giventer* v. *Arnow,* 37 N.Y.2d 305, 308, 372 N.Y.S.2d 63, 333 N.E.2d 366 (1975). Accordingly, the agreement to pay the contingent amount of interest to FRB—NY is not void as an illegal agreement under New York law.

VII.

Upon consideration of all of the evidence and resolving the issues of credibility and in the light of the unprecedented circumstances prevailing at the time I find and conclude that it has been credibly established that all aspects of the October 8, 1974 transactions were legal and well within the range of reason and constituted the best results available on an overall basis. The Receiver did not profit at the expense of the Estate, it exercised sufficiently informed reasonable business judgment and the challenged aspects of the transactions were fair and not a breach of its fiduciary duty to the creditors and stockholders of Franklin National Bank.

VIII.

The foregoing shall constitute the findings of fact and conclusions of law required by Rule 52(a) of the Federal Rules of Civil Procedure.

The complaint is accordingly dismissed, with costs and judgment shall be entered herein in favor of the defendants against the plaintiff and the plaintiffs-intervenors.

SO ORDERED.

APPENDIX D

Judgment of Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

79-7702
79-7703

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-fifth day of July, one thousand nine hundred and eighty.

Present:

HON. JAMES L. OAKES, HON. THOMAS J. MESKILL, *C.JJ.*,
HON. DUDLEY B. BONSAL, *D.J.*

Circuit Judges.

SOL NEIL CORBIN, as Trustee in Bankruptcy of FRANKLIN NEW YORK CORP.,

Plaintiff-Appellant,

and

CONNECTICUT GENERAL LIFE INSURANCE CO., *et al.*,

Plaintiff-Intervenors-Appellants,

—against—

FEDERAL RESERVE BANK OF NEW YORK, *et al.*,

Defendants-Appellees.

Appendix D—Judgment of Court of Appeals

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the appellants.

A. DANIEL FUSARO,
Clerk

/s/ ARTHUR HELLER
By: Arthur Heller,
Deputy Clerk

APPENDIX E

Court of Appeals Order Denying Petition for Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

79-7702
79-7703

At a Stated Term of the United States Court of Appeals in and for the Second Circuit, held at the United States Court House, in the City of New York, on the ninth day of September, one thousand nine hundred and eighty.

Present:

HON. JAMES L. OAKES, HON. THOMAS J. MESKILL,

Circuit Judges.

HON. DUDLEY B. BONSAL,

District Judge.

SOL NEIL CORBIN, as Trustee in Bankruptcy of FRANKLIN NEW YORK CORP.,

Plaintiff-Appellant,

—and—

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, BERKSHIRE LIFE INSURANCE COMPANY, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY, MANUFACTURERS HANOVER TRUST COMPANY, as Trustee, THE MINNESOTA MUTUAL LIFE INSURANCE COMPANY, MORGAN GUARANTY TRUST

Appendix E—Court of Appeals Order Denying Petition for Rehearing

Co., as Trustee, New England Mutual Life Insurance Company, San Francisco City and County Employees' Retirement System, Shell Pension Trust, Southland Life Insurance Company, State of Wisconsin Investment Board, United California Bank, as Trustee, United States Trust Company of New York, as Trustee, and Western Life Insurance Company,

Plaintiffs-Intervenors-Appellants

—against—

Federal Reserve Bank of New York, Federal Deposit Insurance Corporation, in its Corporate Capacity and as Receiver of Franklin National Bank,

Defendants-Appellees

A petition for a rehearing having been filed herein by counsel for the Plaintiff-Appellant,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

/s/ A. Daniel Fusaro
A. Daniel Fusaro,
Clerk

APPENDIX F

Court of Appeals Order Denying Petition for Rehearing *In Banc*

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

79-7702
79-7703

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the ninth day of September, one thousand nine hundred and eighty.

SOL NEIL CORBIN, as Trustee in Bankruptcy of FRANKLIN NEW YORK CORPORATION,

Plaintiff-Appellant,

and

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, *et al.*,

Plaintiff-Intervenors-Appellants,

—against—

FEDERAL RESERVE BANK OF NEW YORK, FEDERAL DEPOSIT INSURANCE CORPORATION, in its Corporate Capacity and as Receiver of FRANKLIN NATIONAL BANK,

Defendants-Appellees.

Appendix F—Court of Appeals Order Denying Petition for Rehearing In Banc

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the plaintiff-appellant, Sol Neil Corbin, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

Judge Kearse took no part in consideration of the question whether to grant rehearing en banc.

/s/ WILFRED FEINBERG
Chief Judge

APPENDIX G

National Bank Act Provisions Involved

Receivership and Liquidation Provisions under the National Bank Act

12 U.S.C. §192.

"On becoming satisfied, as specified in sections 131 and 132 of this title, that any association has refused to pay its circulating notes as therein mentioned, and is in default, the Comptroller of the Currency may forthwith appoint a receiver, and require of him such bond and security as he deems proper. Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct. Such receiver shall pay over all moneys so made to the Treasurer of the United States, subject to the order of the comptroller, and also make report to the comptroller of all his acts and proceedings.

"Provided, That the comptroller may, if he deems proper, deposit any of the money so made in any regular Government depositary, or in any State or national bank either of the city or town in which the insolvent bank was located, or of a city or town as adjacent thereto as practicable; if such deposit is made he shall require the depositary to deposit United States bonds or other satisfactory securities with the Treasurer of the United States for the safe-keeping and prompt payment of the money so deposited: Provided, That no security in the form of deposit of United

States bonds, or otherwise, shall be required in the case of such parts of the deposits as are insured under section 264 of this title. Such depository shall pay upon such money interest at such rate as the comptroller may prescribe, not less, however, than 2 per centum per annum upon the average monthly amount of such deposits."

12 U.S.C. §194

"From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held."

12 U.S.C. §91

"All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application

of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court."